WAR AND NATIONAL FINANCE

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BY

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LONDON
EDWARD ARNOLD & CO.
1921

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INTRODUCTION

The articles which follow were written for *The Round Table* between the years 1912 and 1920. They all deal in one way or another with the effects of war on the financial and economic structure of this country and the British Empire. I make no claim to be a trained economist, and the articles were, all of them, written in the midst of a busy life and from a practical standpoint. I have thought it preferable, nevertheless, to leave them exactly as they were written, except for the omission of certain redundant passages. The reader must judge to what extent they correctly portrayed and predicted before, during and after the war the actual course of events.

The articles do not afford a continuous commentary on the financial history of the war, because owing to the pressure of war work and my absence for a year in the United States I was unable to write anything between the end of 1916 and the Armistice. The last two years of the war, however, so far as internal finance went, represented the continued application, on a constantly growing scale, of the principles and methods elaborated in the first two years; so far as concerned external finance—by far the greatest and most serious problem—our task was after March, 1917, comparatively simple owing to the entry of the United States on our side. I should mention that the article bearing the title of "Finance in War" was written in collaboration with Mr. F. Perry, Quondam Fellow of All Souls College, Oxford; that the article on Reparation was written by me after having acted for three months at the Peace Conference as Financial Adviser to Lord Robert Cecil in his capacity as Chairman of the Supreme Economic Council; and that the article on the Brussels Conference was written after my return from acting as Vice-

President of the International Financial Conference at Brussels.

It is a common accusation against economists and financiers that in 1914 they predicted that financial difficulties would bring the war to an end in a few months. I do not think that any support for this particular accusation can be found in the following pages. In December, 1914, I pointed out that "all history goes to show that actual want of money or financial distress has seldom brought a war to an end"; and that "so long as a Government has a printing-press, it can always make 'money'." I stated very definitely my opinion that, so long as a nation can "find the absolute necessities of life and warfare either by producing them or buying them," it can go on so long as it has the will to continue and that therefore even the financial problem was largely psychological. The Great War has amply confirmed the correctness of these views.

But has the public ever realized how urgent, as the war went on year after year, became the question whether the Allies actually could "find the absolute necessities of life and warfare"? They certainly could not produce them. Could they go on "buying them"? The vital character of this problem was, I think, never generally appreciated, for one reason because it was highly important at the time that the true facts should not be disclosed. Indeed, some of the very highest authorities probably never thoroughly examined the problem or grasped what it involved, until the fortunate entry of the United States into the war relieved them of the necessity of thinking about it at all. It is, however, beyond doubt in my opinion that, had the United States not entered the war, financial difficulties, in other words inability to purchase what we wanted from abroad, would have had the gravest consequences on the whole Allied operations. I have printed as an Appendix a memorandum drawn up in August, 1916, by Mr. Perry and myself. It was our view that, while the Treasury fully appreciated the seriousness of the situation, other Ministers did not, and that it was important to draw their attention to it. In our capacity as members of the Imperial Munitions Board of Canada we were aware of the extent of the financial obligations of the British Government in the United States and Canada, while our experience in international finance

gave us a knowledge of the conditions and character of the New York money market. We predicted, as will be seen, that a crisis would occur some time between June and December, 1917. It did actually ripen earlier. At the very moment that the United States came into the war, the British Government, with commitments in the United States running into hundreds of millions of pounds, was at the end of its tether. It had no means whatever of meeting them. Between that date and the Armistice it borrowed from the American Government to pay for "absolute necessities of life and warfare" not far short of £1,000,000,000, while the other Allies borrowed roughly another £1,000,000,000. If we could picture to our imaginations what these figures meant, when translated into munitions of war, food, ships and so on, we should begin to realize what would have been the effect on our operations of going without them—as well as without American naval and military co-operation itself. Regarded from this aspect alone, the unlimited submarine warfare of the Germans was one of the most colossal mistakes in history. The financial blockade, which circumstances would have imposed on us, would have been more effective, by itself, than was the submarine blockade after the United States had come in.

Some people with easy optimism say that, even if the United States had not come into the war, the American financial world would have gone on lending the Allies as much as they wanted or at any rate very large sums, in order to dispose of their goods and products at profitable prices. That is not my view; and surely it is contradicted by what has happened since the Armistice. America has wished in the last year or two to dispose of vast quantities of goods, which Europe has wanted to buy. But Europe cannot pay for them and the American money market has found it impossible to finance their export on credit. The root difficulty has been the incapacity of the American investment market to absorb any large quantity of foreign securities. It took a very long time even to absorb the Anglo-French loan of £100,000,000 issued in 1915 when the credit of both borrowing countries was undoubted. I believe, indeed, that American financiers would have been forced to devise some means of financing the commitments

comparison between a society founded generally on private enterprise, initiative and saving and one founded generally on public ownership and control.

The Capitalist system, i.e., the system of private property, far from being a failure, has been, so far as wealth production is concerned, an unquestionable success. As developed in the last century it is very largely the direct cause of the huge increase in the world's population. Whether life becomes more tolerable, the more numerous we become and the more crowded we are in great cities, is quite another question. But we have all been born into the world and must now be fed, clothed, housed and amused. The bulk of us may be so dissatisfied with the whole business, that we may revolt and try to overturn society. But, if we do, we shall starve, unless we quickly re-make it on very much the same lines as it was before. I have always been convinced that, left to itself, the Soviet experiment in Russia will result in a form of society in a very short time almost indistinguishable from that which it replaced. We see the process already beginning now. If we are to live with any comfort at all, we must indeed choose that system which is most efficient in the production of wealth, and it is for that reason that I regard our present system or something very similar as likely to last for much longer than some of its critics suppose. In time it will no doubt be profoundly modified. But radical indeed must be the change in Western civilization before the abandonment occurs of that speculative area in industrial and commercial life, where profits and losses are made, and for which private property and private enterprise are essential.

WAR AND NATIONAL FINANCE

I

LOMBARD STREET AND WAR

(March, 1912)

A British Government ought to know what effect the outbreak of war is likely to produce in Lombard and Throgmorton Streets and what measures it may have to enforce to forestall a financial crisis, just as much as it should have plans for the strategic disposition of its naval and military forces. In ordinary times, no doubt, the less a Government interferes with the delicate mechanism of finance the better. But there may be times when, owing to our peculiar banking laws, it must act, and then it will be of the first importance that it should act with knowledge. At present one is almost entitled to suspect that just as the War Office will train the Territorials, so the Treasury hopes to acquire a knowledge of its duties, after and not before war has broken out, instead of keeping in close touch with the financial community at all times, and making, in consultation with it, preparations for all emergencies.

The object of the following pages is not, however, to teach the Government its duties. It is the more modest one of attempting to sketch, in broad lines, what may be called London's place in the world of finance and Lombard Street's capacity to meet the shock of war. That is a matter which vitally affects every citizen of the British Empire, the South African and Canadian as much as the Englishman and Scotchman. There is no parallel to the position which London holds, nor has the modern-world system of credit ever been really subjected to the test of war. While, therefore, much that is

said must be conjectural, the subject may perhaps derive an added interest from the uncertainties which surround it. There is a further reason for clear thinking on the subject. Much is said in these days about finance making war impossible. A clear perspective of the subject may better enable us to decide on the truth of this dictum and on the extent to which modern developments of the credit machinery have eliminated the fundamental causes of conflict between nations.

I

At the height of the recent Morocco crisis the world learnt that the great German financiers, appalled at the chaos into which, as they believed, war would plunge German trade and German credit, were putting strong pressure on their Government in the cause of peace. Even the apprehension of war had brought the Berlin bourse into a pitiable state of nerves, which the Government were obliged to relieve by soothing measures. It became clear to the world that credit had no frontiers, and that the largest army in the world and the strongest fortresses were powerless before the invisible forces of distrust. But Germany was not alone in her discomfort. She was thought, indeed, to be particularly vulnerable owing to her peculiar dependence on foreign money and credit. Yet other nations were in much the same plight. It was clear that no great war-shock could be given to the nerve system of international credit without bringing with it the danger of general paralysis.

The world had had also a few years before another proof of the growing interdependence of modern nations in the American monetary crisis of 1907. There was hardly a civilized country, hardly indeed any industry in any civilized country, which was not affected in some way or other by the sudden collapse of American credit and the consequent paralysis of American trade, external and internal. Among its manifold consequences, for instance, may be placed the smooth passage of the Union of South Africa. During some months American women ceased almost entirely to buy diamonds. Since they buy far more diamonds than the women of any

other nation, the diamond trade which is centred almost wholly in South Africa, was completely disorganized. The finances of the Cape Colony, being largely dependent on the revenue from the diamond trade, were thrown into confusion, and in consequence the Cape Colony was induced to agree to unite with the other South African colonies on terms to which in her days of prosperity she would never have agreed. This perhaps may stand simply as a curious example of the far-reaching effects of modern trade. Yet it is hardly to be wondered at that the sudden stagnation of the great American market, coming as it did on the top of a period of general over-trading, had serious consequences all over the world. The shock to international credit, accompanied by a huge shrinkage in the value of American securities, many millions of which are held in England and on the Continent, had results equally far reaching.

It is unnecessary to multiply examples. The effects of a financial crisis are indeed clear enough. But what are the causes? Why is it that failure of credit has such a paralysing effect on industry and trade? In what way are modern nations coupled together like a train of railway trucks so that a shock to the credit of one is inevitably transmitted to all the rest? To outsiders the money-market seems a dull subject, perhaps because it is difficult to explain it in any but a dull way. Like philosophy it has a language of its own, full of unintelligible technicalities, which only become intelligible if one uses them in one's daily life. But since ignorance or indifference to the subject may bring the most unpleasant consequences to the inhabitants not only of the United Kingdom, but the British Empire too, some attempt to throw a little light upon it may be excused.

The system of banking and credit, without which our modern world would never have come into being, performs several indispensable functions for society. A bank concentrates the money of the community, so that it is accessible and available. A million pounds scattered through the community in tens and fifties are quite useless for the production of wealth. Concentrated in a bank they are at the service of the enterprising section of the community. They can be lent to

those who can give the bank proper security, and can be used continuously and in endless ways to enrich mankind. A bank therefore forms a bridge between those who have money, but no opportunity for its profitable use, and those who could use it profitably but have too little of it. Just as a huge wholesale store collects and distributes goods for its customers, so a bank collects and distributes capital. But if banks had been restricted simply to lending out the metal currency their depositors brought them they would never have gone far towards changing the face of the world. Some inventive genius discovered that if a bank could persuade people to use a currency of its own as a supplement to the metal currency, it could lend more "money" than its depositors had brought it. It could then enormously extend its operations. There was vastly more wealth in the world in the hands or at the call of enterprising men than the small amount which banks could take in pledge in return for the loan of actual gold or silver. Would not the public take the bank's promise to pay gold instead of the gold itself? It was true that gold must always be paid when demanded and that the more promises to pay there were, the more difficult it might be to do so in any time of stress. But still depositors must be judged as reasonable men, and if the bank were well conducted they would probably make no unreasonable demands for cash. Thus in bank notes a new form of currency was invented, which still does duty to a greater or less degree in every country. In Great Britain and her Dominions and in the United States the last few decades have seen a further refinement of banking. Cheques have almost superseded bank notes, while in other countries, such as Germany, a highly developed system of transfer to some extent takes their place. Banks lend money, not in gold or notes, but merely in the form of a book credit, or a right to draw cheques. These extraordinarily simple forms of currency, unlike gold, cost a bank practically nothing to make and are therefore a source of great profit. And to the public they are vastly more convenient.

Imagine the modern world of trade if every debt had to be redeemed in gold. It could never have come into being. There is not a merchant or financier or stock-broker who has

not every day to be meeting large liabilities. If a merchant wishes to-morrow to pay a debt of £10,000, he draws a cheque on his bank. If there was no bank, or if the bank had closed its doors, he could not pay. He could never find the gold. There would be no machinery for payment. The collapse of the banking system would mean nothing short of the immediate cessation of the production and distribution of wealth as we know it.

What is the significance of this discovery of credit? Before credit was invented the only wealth which was "liquid" or "employable" was gold and silver. They were the only currency in which labour could be paid and materials purchased. They were not only limited in amount, but still more limited by the difficulty of their transfer. To send a million pounds from London to New York was, apart from its great risk, a matter of months. The same sum can now be transmitted in half an hour by the despatch of a cable. By the invention of credit, which in its modern development would not be possible without the telegraph, the telephone, the steamship and the railway, a bank has power to give life to a great mass of dead wealth, to "mobilize" it. Land, commodities, precious stones, stocks and shares, bills of exchange, in short, all forms of or rights to wealth, which have indeed value but are not currency and are useless for the payment of labour or the purchase of materials, can be taken to a bank, pledged to it, and the owner receive in return the bank's currency either in notes, or, as in the British Empire and the United States, in the form of the right to draw cheques. By this simple process this dead wealth is turned into currency and made available for any use to which the borrower desires to put it.

It is no exaggeration to say that almost the whole of modern trade and industry is based, in this way, on borrowed money—borrowed either from unsuspecting depositors, who have no inkling of the uses to which their money is put, or from the banks themselves by means of the currency they create. If there were no banks from which to borrow, trade and industry would shrivel up just as a balloon shrivels up on an escape of gas. So long as the money is borrowed to finance safe undertakings, and, in particular, the production and distribution of

the great necessities of life, it is wholly legitimate. If traders, and merchants, and producers had to wait for their money until the actual buyers of their products could pay, the wheels of commerce would never go round at all. The cotton grower could not get paid until the cotton spinner had sold his yarn ; the wholesale buyer of yarn could not pay the cotton spinner until the retail merchants had paid him ; and the latter could not pay until they had disposed of their purchases in detail to their customers. Thus the cotton grower would have no money to begin sowing and tending his crop ; the spinner no money to pay his wages ; the wholesale merchant no money to replenish his warehouses. They must all wait months till the retailer had sold his stocks. And this, not because the transaction was doubtful or risky, but simply because the wealth in the cotton at its different stages was not employable. All this is altered by the loan of banking currency. The producer, the manufacturer, and the merchant can all turn their wealth into money at once, simply by pledging with the bank that wealth in its different forms of raw cotton and finished yarn. This process, by which the banks "carry" the immobile wealth of the world, is universal in trade and industry. In those countries where land and mortgage banks are developed, the same principle is fully extended to agriculture, to its immense advantage. Instead of being flush of money when he can sell his produce and short at other times, a farmer can raise what he wants at such times as suit him.

There is, therefore, nothing intangible in credit. It has at its back wealth of some kind or other which the bank lending the credit supposes to be of at least equal value to it. The borrower has pledged his wealth to the bank ; the bank has lent its currency to the borrower. Even if a borrower is given a "blank credit" or an "over-draft," the loan is made against the value of his supposed capital. Credit which is given without security of some kind is illegitimate. At first sight there seems no reason why this delightfully simple process of manufacturing money, which costs nothing to make, should be limited by anything except the amount of wealth there is in the world to pledge. And there would be no reason, if the roseate schemes of borrowers were always fulfilled ; if nature was

never capricious, and depositors always reasonable. For then every bank would always be repaid its loans with interest, and depositors' money would never be in danger. Unfortunately the prescience of borrowers and banks is far from perfect.

"The best laid schemes of mice and men gang aft agley."

Even if human frailty became human perfection, nature would still be fitful. A bad harvest may follow a good one; a promising mine "peter out." The borrower may have successfully estimated his market, or, in other words, the wants and fashions of men, and yet nature upset his plans. Take the cotton trade. The loans made by the banks are based on estimates of the cotton harvest, the market for cotton, the other demands for credit which must be satisfied, the signs of the political sky, and so on. None of these are under the banks' control. There is not a day in the year on which bankers must not take account of the changes and chances of this mortal life. In fact, as long experience has taught, the limitations to credit are very definite, and the path of history is strewn with the wrecks of banks which have ignored them. Enterprising men, especially in optimistic times, become too enterprising. Over-production may bring a crash, and over-production merely means that banks and borrowers in general have taken too rosy a view of the future. Depositors may take fright. Something unforeseen may happen, and what is unexpected and unforeseen is bound to make banks uncomfortable.

This system of banking and credit, in its origin peculiarly British, has been rapidly extended in the last fifty years over the face of the civilized globe, and is binding all nations together to an extent hardly yet recognized. The credits which one bank gives, becomes the deposits of another. You may receive a credit of £100,000 from a London bank which you may utilize to pay wages or to buy materials in the Argentine. Those whom you pay or from whom you buy repay the money into their banks again and it is again available, but in another country. You may buy securities in America. Your money goes to swell the American banking deposits. You may buy wheat from Russia. Your money is transferred to a Russian

bank. Thus the great mass of banking currency, representing the employable wealth of the world, circulates incessantly from bank to bank, from country to country. The result has deen vastly to increase the liquid wealth of the world and to accelerate its development. Great masses of capital are heaped up in the national banking centres in London, New York, Paris and Berlin. Every year its concentration becomes more pronounced in those great centres where the machinery for its employment is most perfect. Vast amounts of capital are available in each country for the development of its own wealth. The great creditor nations, Great Britain and France, which have more capital than they can profitably consume in their own countries, lend out yearly huge sums for permanent investment in any country and for any enterprise which promises a sufficient reward. France has turned her attention, mainly to Europe and Latin America, England to the whole world, but to Europe least of all. On the other hand, debtor nations, like Canada and the Argentine, absorb all and more than all their savings, and even the United States and Germany have comparatively little for investment in other countries.

But it is not only by means of permanent investment in one country or another, through the medium of a public issue in the market, that these great masses of capital find employment. Much of it is suitable only for temporary investment in the short loan markets of the world, either in the discount of commercial bills or by means of loans to the Stock Exchange. Every bank must keep no small proportion of its money "on call," and this floating supply is invested for short periods in that market where rates are favourable. If money is cheap in New York—i.e., if the banks have created or borrowed more money than the enterprise of the country can at that moment utilize—American money flows to London, Paris or Berlin; if money is cheap in Paris, as it generally is, it finds investment in England and Germany. Between all these great national reservoirs of capital there is thus constantly flowing a great stream of capital for temporary investment, regulated by the value of money in each of them. Moreover, in addition to the permanent investment of the citizens of one country in the undertakings of another, and the temporary

employment by one banking centre of large amounts of money in the short loan market of others, the great banks of such centres as London, New York, Paris, and Berlin are constantly employing their funds and their credit in financing foreign trade and in making loans on the security of wealth and property in all parts of the world. Every day, therefore, the dependence of the banking community in one country on the soundness of the banking community in every other brings closer together the economic interests of all nations. Both creditor and debtor nations are vitally interested in one another's welfare. On the one hand the investors of a creditor nation can hardly help wishing for the prosperity of the country in which they have invested their money. On the other, a new country with little capital of its own depends on the continued import of capital to an extent which those who live in an old country can hardly comprehend.

We see attempts being made by Governments to determine the channels into which the surplus capital of their citizens shall and shall not flow. France refuses a loan to Austria, because Austria is a member of the Triple Alliance; the German Government tries to prohibit the investment of German money in foreign undertakings. Great as may be the political effect of such action, it can never in the long run wholly attain its object economically. It is like trying to dam a river by erecting a wall across a part of its stream. The water finds its way round another side. English papers have lately applauded the patriotic determination of Frenchmen not to invest money in loans which might, at any rate indirectly, be utilized for the construction of German and Austrian Dreadnoughts. But what do we do? We lend German trade and industry many millions through our credit system without any fuss. And if we did not lend money to Germany, we should lend it to some other country, whose prosperity would be thereby improved, and whose trade with Germany would also, in consequence, almost certainly be improved. France may determine to lend to Russia and not to Germany. Germany's trade with Russia is thereupon improved with the improvement of Russia's financial position. We may lend money to the Argentine; the Argentine will trade more with us, but she will also

trade more with Germany. In fact, surplus capital is bound to be employed somewhere. Left to itself it will seek the most profitable channels; if its movements are restricted, it will have to seek less profitable channels. But the net result of its employment will always be an increase in the world's wealth, and that will mean more trade not only to the country supplying the capital but to every active trading country as well. If we want to be prosperous, we must face the fact that our prosperity will also mean our rivals' prosperity too.

In truth, an infinite number of strands binds all the great nations to one another, and, like the nerves of the human body, these strands radiate from the great nerve centres of credit. And the more they spread out through the world the more sensitive become those centres to the welfare or misfortunes of every part they touch. Credit depends on normal times. The nature and extent of credit are based on a very great number of estimates of profitable enterprise in all parts of the world made jointly by a great number of traders, manufacturers and others, and a great number of bankers in the credit centres of the world. If these estimates have been incorrectly gauged, the stability of the banks may be endangered. Their assets may be locked up in loans, which cannot be realized, and their depositors may be demanding gold. Whatever in any part of the world affects those who are employing the bank's money or credit affects the banks. Now all the estimates made are based on the supposition that nothing abnormal will occur to upset them. No doubt some of the estimates will prove to be wrong, even if nothing unexpected occurs. But in normal times most of them will work out fairly correctly. On the other hand, anything abnormal, a great strike, some catastrophe of nature, or above all a war, may upset all estimates alike. Take as an instance of something abnormal the payment of the French indemnity to Germany in 1873. In two years Germany received the huge sum of £200,000,000. And yet this increase of wealth was followed by deep depression. It was the sudden and unexpected supply of capital which upset all calculations in Germany. Money became exceedingly cheap; speculation was fostered, and all sorts of enterprises were undertaken for which there was no real demand, with

the inevitable consequence of subsequent depression. It is in these abnormal times, as in New York in 1907, that the foundation on which credit rests suddenly reveals itself. Credit depends on confidence and confidence depends first on the belief in the soundness of the banking world, and secondly on the belief that every creditor of a bank can get gold if he is entitled to it. If estimates were never wrong and nature never capricious, there would be no need for gold. But as it is, gold is required because gold in addition to being currency is also a form of wealth itself. While a bank note and a cheque are worth nothing by themselves and lose in a crisis the extrinsic value which confidence gives them, gold has an intrinsic value of its own. If a depositor has his money in gold, he may be indifferent to the fate of his bank, because the value of the gold is wholly independent of credit. Of course, no one supposes that a bank is ever, or should be ever, in a position to pay all its liabilities in gold at any one time. If it were so, there would be no such thing as credit. The art of banking is to speculate with success on the chance that only a small proportion of creditors will ask for their money in gold at the same moment. But they *may* all demand it. And that will be in a time when any bank, however strong, will probably find it very difficult to realize its assets or obtain gold either from within or without the national borders.

Gold is the only universally acceptable form of currency. Not only is it the indispensable foundation on which to build a stable banking system, but it is the sole means for settling the balance of indebtedness between one nation and another. When their respective debts have been set off against one another the balance must be settled in gold. Every civilized country, therefore, with a developed banking system must have a big reserve of gold.

And since it is the foundation of their credit, they must not only have it but hold it. If one nation is passing through a crisis, and in its thirst for gold hastens to liquidate all its assets abroad—like the United States in 1907—and to demand payment in gold, are these great banks to hand out their precious gold to any one who asks for it, so that it may be sent away just when a nervous tremor may be beginning to pass through

their own community? And yet, somehow or other, the gold must be had. If Europe owes America money she must pay it, and pay it in an acceptable currency. If gold is the only currency left, gold must be sent. Gold must be always available somewhere. And it is always available, but only from one place in the world. London, alone among the great financial centres, has undertaken the task of meeting every legitimate demand in gold at all times and to any amount. No other banking nation has ventured to face the risk of meeting not only the demands of its own depositors but of the world itself. If Germany has to pay gold to Turkey for a loan newly granted, she gets it from London; if New York wants gold, she gets it from London; if the Argentine or Egypt or India have had good harvests and want gold, they get it from London. You may study any day in *The Times* the gold movements of the world. The following is an extract taken at random:

> "When it became known fairly early that a considerable amount of gold was being withdrawn from the Bank on German account, and that an equal sum was almost certain to be taken to-day for the same quarter, the market stiffened up again and the bills ceased to be offered freely. The prospect of great pressure at the end of the month makes the market very sensitive to all influences which are likely to reduce the available supply of cash during the next few days. Much interest was shown in the wanderings of the £400,000 in sovereigns which were sent a short while ago to Constantinople and have now left that city. We believe that about three-quarters of the total will reach London, and probably be sent to the Bank before the end of the year, of which two parcels of £100,000 each are likely to arrive on Thursday and Friday next. We also hear that Switzerland's gold requirements are not yet satisfied, and that another £100,000 of the South African bars may be taken for that quarter. It is still uncertain whether the Bank will secure any of the South African parcel; it has received none as yet."

Since 1895 the world's gold has increased by £1,000,000,000. A great portion of this huge sum has passed through London, because London is a free market. Gold comes there freely, because it can be freely taken away again, a matter, as we shall see, of immense importance to our credit. But we have retained little. Since 1895, while the United States have absorbed about £200,000,000 and Russia and other

countries very large amounts, London, the great gold mart of the world, has retained only about £20,000,000 or £30,000,000.

This long and somewhat academic discussion may perhaps make clearer some of the causes why a financial crisis in one country at once affects all other banking countries. There are less immediate causes in the consequent stagnation and dislocation of trade, and the fall in the value of securities, and these, if important, may themselves endanger credit as a whole. But the immediate cause is that a banking country in trouble at once develops a thirst for gold, which can only be satisfied by the attraction of gold from other centres. And since gold is the foundation of every credit system, every money market immediately becomes frightened. A crisis is, therefore, infectious, and on an outbreak every country becomes apprehensive, restricts its supply of credit and makes preparation for the possible extension of the disease to itself.

II

The London banker or bill-broker, whose business lies in the money market, must, as he goes down to the City in the morning, scan the world horizon from China to Peru. He must look what gold shipments are reported into and out of the Bank, what is the rate for money and bills in Paris and Berlin, whether money is cheap or dear in New York. He must examine the foreign exchanges to note whether they indicate probable movements of gold to or from London. He will scan anxiously the political news in every part of the world. Anything which disturbs the normal course of affairs, whether it is political trouble in Europe, the failure of a harvest in the Argentine, financial trouble in New York, over-speculation in Berlin—anything that is which may possibly affect the reserve of gold in London, and through it the rate for money, directly affects his pocket.

For London undertakes to supply at any time and to any amount gold—that metal which is the basis of every great system of credit and which may at any moment be wanted to the extent of millions of pounds to support them. She undertakes to supply on demand not only the countless de-

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positors in her own banks, but the world at large. Anybody in the world who keeps money in London or can raise a credit or get an advance in London can get gold from the Bank of England. Any nation in a bad way and wanting gold can draw it from London if it has debts abroad which it can liquidate. In 1907 America drew nearly £15,000,000 in two months from London. The Bank of England's reserve fell over £6,000,000 in two weeks. There is no other nation which has been able to undertake these tremendous responsibilities. America is determined to wrest London's supremacy from her some day, and if London were ever in difficulties New York would make a great bid for her place. She will soon have the surplus wealth and foreign trade needed; all she requires is a good currency and banking system and the reputation for prudence and soundness instead of for magnificent speculation. Hitherto, however, while Americans boast that New York too is a free market for gold, London has not been seriously challenged. In good times New York is a free market. But it is only four years since every bank in the States suspended specie payments. No market can rival London until it is ready to pay in gold in foul weather as well as fair. France has never attempted to face the responsibility since 1870, nor will Paris ever be a serious competitor so long as the Bank of France is legally entitled to redeem its debts in silver as well as gold at its option. Berlin aspires to be an international market. But as yet she has put forward no serious claim. The Imperial Bank of Germany asserts that gold can be had from it as easily as from the Bank of England. But nobody believes it. There is a universal opinion, surprisingly persistent, if it be ill-founded, that a black mark is entered by the Imperial Bank against the name of the unhappy bank which dares to ask for gold at an inconvenient season. In short, no other financial centre has shown strength to undertake those responsibiliites which London shoulders without a thought.

London is the bank of the world and the world's clearing house. Civilized nations bank with London for the same reasons that lead most Englishmen to bank with a big clearing bank. An Englishman chooses a bank because he feels sure

his money is safe, and because he knows he can always get it when he wants it. As a rule, he chooses a big bank, because its name is known everywhere, and a cheque drawn on it is accepted readily. This greatly simplifies his money transactions. Finally, he prefers that bank which is likely to accommodate him with a loan when he needs one. The very same reasons have made London the world's financial centre. London has always been thought the safest place in the world. You have only to read Bagehot to see how modern is the idea that defeat or invasion, or even war itself, need be considered as the possible cause of a financial crisis in London. It seemed impossible only a few years ago that the British fleet should be seriously challenged. More important still, foreign countries were satisfied that they could always get their money back when they wanted it and get it in gold.

But these advantages, important as they are, would never have created Lombard Street without Great Britain's gigantic and world-wide trade. Almost before any other nation had started on the road English trade had penetrated into every corner of the known world, and with it the names of the great merchant bankers of London. For the exports from England had to be paid for, and they could be paid for most easily by buying bills which had been drawn on London by merchants as a means of obtaining payment for the goods they were importing to England. In this convenient way the one transaction was set off against the other. The sender of goods to England drew a bill on some well-known London house for the amount owing to him, and sold it to the man who had exported goods from England. The latter sent it in payment to the merchant in England from whom he had his goods. Thus both transactions were completed, and thus bills on London came to be more sought after than any other. They were known everywhere to be as good as gold. So great indeed is the prestige and worth of a London bill that it is used to finance not only English trade but a large portion of the trade of the world itself. It has become the chief form of international currency. The United States might be thought wealthy enough to finance their own trade. But New York possesses no discount market, and in any case the history of their banking

system is too chequered for bills on New York to be an acceptable form of currency. The bulk of American trade with foreign countries is therefore financed by bills on London. If a rubber merchant in Brazil sends rubber to New York, he repays himself by drawing a bill on a London house. If a Japanese trader sends jute from Calcutta to Tokyo, he finances it through London; if a German firm in Hamburg imports coffee from Santos, the trade is generally financed in London. Thus, just as we saw that a bank's chief function was to supply currency to its customers, so London supplies the world with currency, without which the world's trade could not be carried on as it now is, and unlocks and makes available the wealth stored up in the goods in transit throughout the world.

Finally, just as an Englishman prefers an accommodating banker, so the world has favoured London, because London has always had money to lend. Every one likes a bank where he can raise money easily on good security. London has been such a bank to the whole world. London has financed the world. She has supplied unstintingly all nations, both with her credit to finance their trade and her surplus wealth to develop their countries. A competent observer * estimates that to-day the investments of Great Britain in other countries reach the huge total of about £3,300,000,000.

His estimate in millions of pounds is as follows:

BRITISH DOMINIONS BEYOND SEAS.

	1896.	1910.	Increase.	Decrease.
India and Ceylon . . .	294	430	136	—
Australasia	323	395	72	—
Africa	333	391	58	—
Canada	140	365	225	—
Other British Dominions . .	33	71	38	—
Total . . .	1,123	1,652	529	—

* "British Investments Abroad." By Edgar Crammond. *Quarterly Review,* 1911.

FOREIGN COUNTRIES.

	1896.	1910.	Increase.	Decrease.
United States	315	610	295	—
Argentine	117	292	175	—
Brazil	45	105	60	—
Mexico	27	73	46	—
Japan	13	69	56	—
Chile	29	44	15	—
Egypt	51	72	21	—
Uruguay	23	36	13	—
China	26	31	5	—
Peru	21	29	8	—
Cuba	5	23	18	—
Europe	254	151	—	103
Other Foreign Countries	43	85	42	—
Total	969	1,620	651	—
Grand Total, British Dominions and Foreign Countries.	2,092	3,272	1,180	103

The catalogue of foreign securities quoted in the London Stock Exchange Daily List is indeed unapproached in any other financial centre. In comparison the Stock Exchanges of New York and Berlin are local affairs, and confine themselves almost entirely to the securities of their respective countries. France, it is true, invests largely abroad, but she is a bad second to London. Great Britain's annual foreign investments amount to about £200,000,000. France's probably to not half that amount. If it is our immense trade to which we owe our position as the world's bankers, that trade rests largely on our foreign investments. It increases and decreases regularly, as they increase or decrease. In a time of peril, they may prove the mainstay of our financial fabric.

In short, London has become the banker of the world, because she has the largest trade, the greatest supply of capital and credit, the longest traditions of commercial fair dealing, a system of banking unrivalled for its elasticity, the freest market,

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and hitherto the completest immunity from attack. Naturally London does not act as universal banker and general middleman for nothing. It has been estimated * that our services in the domain of international trade and finance are rewarded by an annual gross income of not less than £50,000,000.

But while the profits are large the responsibilities and risks may be larger still. Is our supply of gold sufficient to carry them in a crisis of magnitude such as a war with Germany, for instance, would provoke ? At such a moment it is only to be expected that our gold reserve will have to meet both an external and an internal drain. If it is clear that Great Britain's command of the sea is undisputed, the acuteness of the crisis will probably rapidly diminish, though, as we shall show, London would have still to deal with some serious problems. If, on the other hand, we were either defeated or in serious danger of defeat, it is more probable than not that our credit system might not be able to meet successfully the demands upon it. The Bank of England would have to suspend specie payments ; London's reputation would be very seriously damaged, and with her fall, international credit would enter on a period of chaos and confusion from which no country in the sphere of her influence would escape without heavy loss.

The only gold reserve in Great Britain is the sum of £35,000,000 or so lying in bullion or coin in the vaults of the Bank of England, together with the stock of metal held by other banks, in all, perhaps, £70,000,000. It is estimated that this sum is equal to not much more than 6 per cent of the total deposits of the banks of the United Kingdom. While the stock scattered about among the different banks is a valuable standby, the final reserve is the reserve of the Bank of England. That is the reserve to which all the banks in the United Kingdom look. The liabilities it carries mount up to many hundreds of millions, to so great a sum, indeed, that if depositors ever really lost their heads the reserve would vanish in a few hours, and the Bank Act would have to be suspended to allow a freer creation of bank-notes, if, indeed,

* "British Investments Abroad." By Edgar Crammond. *Quarterly Review*, 1911.

depositors at such a moment remained long satisfied with bank-notes. All the smaller banks, and all the provincial and Scotch and Irish banks look to the great clearing banks for supplying them with gold in time of need, and the clearing banks look to the Bank of England. In the balance sheet of every clearing bank appears, among the assets, an item "Cash in hand and at Bank of England," the amount bearing, as a rule, a proportion of about 8 per cent to 10 per cent of the bank's liabilities. What proportion is actual cash in hand and what proportion "cash" at the Bank of England it is impossible to say, since the figures are not published separately. But it is tolerably certain that the "cash" at the Bank of England is more than 50 per cent. of the whole. As a matter of fact this item is not really cash. It is not represented in actual fact by cash to the extent of more than one-third. And, moreover, not even the clearing banks' "cash in hand" is really all cash. It is always, to some extent, composed of bank-notes, which themselves are only partially backed by cash. "Cash in hand and at the Bank of England" consists itself, therefore, largely of credit, and on this basis the clearing banks build a further towering edifice. Moreover, the Government itself has very large liabilities to the public. The deposits in the Post Office Savings Bank amount to about £160,000,000. It is true that the Savings Bank is more of a Trust Company for investment than a Bank. But it is different from other Trust or Investment Companies, in that its depositors may demand their money back on three days' notice. In a crisis many of them would probably withdraw their money, and if they demanded cash, cash could only be got from the Bank of England.

Notwithstanding these large domestic liabilities, a purely internal crisis without some external disturbing cause is unlikely. The art of banking is now too well understood in this country, and bankers enjoy unreservedly, and justly enjoy, the confidence of the public. In the past, internal crises were common. From time to time trouble of one kind or another may occur again, but the methods of dealing with it and of preventing any spread of the infection are now well understood. The banking system is too strongly established for any such crisis to bring about a complete collapse of credit. A storm,

if it comes, will come from another quarter. It is our foreign creditors who will constitute the danger.

There is usually a vast deal of foreign money in London. It was shown earlier that the result of the modern credit system was to heap up masses of liquid capital in the great financial centres, a good part of which must be immediately available to meet any sudden liabilities, and that there is in consequence always a great mass of capital looking for investment in the world's short loan market. London has the largest short loan market because she has incomparably the most important discount market, due to her position as the world's clearing house, and, outside New York, the greatest market for the employment of money on the Stock Exchange. There is always, therefore, a large amount of foreign money temporarily vested in Lombard and Throgmorton Streets, and if the rates of interest and discount are more favourable there than they are in New York, Paris, or elsewhere, as is often the case, the sum runs into very large figures. Then, again, there is hardly a financial institution of importance in the world which is not either directly or indirectly represented in London. An increasing number of foreign and colonial banks have opened their own branches there. There are now branches of twenty-eight foreign banks in London, representing a capital of about £100,000,000, and total assets of £716,000,000, while the assets of the Colonial banks with branches in London, now stand at about £400,000,000. By their use of our credit system in the manner referred to below, these banks—and particularly the agencies of foreign banks—reduce the amount of their own money employed to a minimum. Nevertheless, in total that amount must be large.

But, apart from this, London has large liabilities to foreign countries of a more peculiar and perhaps more dangerous nature. London lends her credit to the world. She lends it indifferently to any nation, so long as the security seems good enough, and the method the borrowers employ is to draw bills of exchange on London. It has been already stated that bills on London are the chief international currency and an international means for balancing accounts. They are therefore employed for all transactions in which international currency

is required. They are used for as many different purposes as there are kinds of financial and commercial transactions. They originated as a means of financing international trade, and that is still their most important function. The best bill of all is still the true commercial bill, because it is generally drawn to finance some article of universal consumption, for which there is always a market.

To explain more clearly the working of such a bill it may be worth while to take the case of an ordinary commercial transaction.

Suppose the agents in Brazil of a German merchant in Hamburg are shipping coffee to that port. The German merchant will have arranged with a London accepting house or bank that he shall be given a credit. When the coffee is shipped, his agents draw a bill for the amount of its value on the London house with whom the credit is opened. Since it is a first-class London bill, any bank in Brazil will discount it, i.e., buy it. So the agents of the German merchant take it and the relative bill of lading to a Brazilian bank and receive from them the price of the coffee. Their part of the transaction is thus closed. They have shipped the goods and got their money. The Brazilian bank sends the bill of exchange and the bill of lading to its branch or agent in London, which takes them to the London house on which the bill is drawn. The bill instructs the London house to pay to the Brazilian bank or its London branch three months after it receives the bill, the sum thereon stated, i.e., the value of the coffee. The London house undertakes to do so, by "accepting" the bill, by signing its name across the face, in return for the bill of lading, i.e., the legal title to the coffee. Thereupon the Brazilian bank sells the bill to a bill-broker in the discount market and it also is now out of the matter, as it has received its money from the bill-broker. The bill-broker probably sells the bill to a Joint Stock Bank, or deposits it as security for a call loan made to him by a bank, and in three months' time the Joint Stock Bank or the bill-broker demands payment from the accepting house. Meanwhile the coffee has gone to Hamburg and has been sold, and out of the proceeds the seller is under obligation to remit to London the amount of the bill a

day or two before the accepting house has to pay the Joint Stock Bank or bill-broker. This is a typical instance of hundreds of transactions which place take daily.

But commercial bills, while, perhaps, the most legitimate form of bill, are only one out of many forms. Very large credits are given by London for all sorts of purposes, other than commercial purposes, to all countries in the world, especially, perhaps, Germany and North and South America, and these credits are utilized by drawing bills. If a loan is made to a foreign country, such money as is wanted there is obtained by drawing and discounting bills on London, whether the loan is to a Government, a corporation or an individual. Bills are used, perhaps, most extensively of all simply as a means of borrowing money. The banks and accepting houses in London will grant credit, for instance, to German or American clients. These latter will raise their money by drawing bills on London for the amount they require. If they want the money in their own country, they will discount the bills there among their own moneyed men, who will in turn remit them for discount to London as and when they wish to replenish their coffers. If they want the money in London they will send the bills direct there and get them discounted in Lombard Street, and the proceeds credited to them.

Now bills on London are drawn not only on English and Colonial banks and institutions but also on the London branches of foreign banks. They are utilized, indeed, by the latter for raising much of the money they need for carrying on their London business, and for maintaining a balance there. From the point of view of the London money market there is, however, an important distinction between the two classes of bills. Those drawn on English banks and houses have behind them all the resources of those banks and houses ; bills drawn on a foreign agency, e.g., by the Deutsche Bank in Berlin on the Deutsche Bank agency in London, have behind them, so far as this country is concerned, only the resources which an English creditor, i.e., the holder of the bill, when it becomes due, can get at. He cannot get at the Deutsche Bank in Berlin ; he does not know what resources of its own its agency in London keeps, nor does he know whether they may not be

removed to Berlin and the London agency simply closed on the outbreak of trouble. This is perhaps too extreme a supposition to be taken seriously. Yet no one can be certain what a war might bring forth. And it is for such reasons that what are known as "foreign agency bills" are not taken as security by the Bank of England.

Thus much has been said about bills because it is important to recognize the nature of Lombard Street's liabilities in respect of them. Bills on London are the usual means of settling all forms of indebtedness between this country and the outside world, and are largely used by other countries also to settle debts as between one another. The Clearing House Authorities have estimated roughly that the amount of foreign and colonial bills paid in London in 1910 was £1,200,000,000. A great part of this sum was on British account, e.g., to finance British trade and undertakings, but probably more still was on foreign account, to finance foreign trade and undertakings. In return for commissions and other perquisites London, therefore, lends her credit to foreigners to the tune of hundreds of millions at a time. It is a profitable trade to make people pay for the use of one's name. But what does it mean? Let us examine the example given above. It was the Brazilian bank which was out of money at first until its branch had sold the bill in London. But it was the Joint Stock Bank or the bill-broker who were out of their money for the remainder of the bill's currency. They had in reality paid the Brazilian bank. The latter could withdraw its money from London on demand. The former would not receive their money through the accepting house from Germany for three months. And this is happening on an enormous scale daily with every country in the world. In the balance sheet of any Joint Stock Bank or discount house you will find an item "Bills discounted," running sometimes into many millions. These represent for the most part bills drawn abroad, whether on English or foreign institutions, which have been bought from all those institutions in London which deal with the outside world, whether they are the big private banking and accepting houses, merchants, foreign and colonial banks, or other Joint Stock Banks themselves. It is these resources of the Joint Stock Banks,

always available for investment in bills, or for loans on the security of bills, which makes the great discount market of London possible, and all those who draw and discount bills on London have in reality borrowed their money for the term of the bills from those banks. The Joint Stock Banks are out of these millions of money until the bills which they hold mature in two, three, four or six months. Meanwhile the money so raised may be called from London without notice. London advances its credit in such a way that vast sums may be called from it without notice, whereas it will not receive the "cover" due for these sums until two or three months later.

The danger, therefore, of London's position is that foreign countries are always in a position to withdraw large sums from the London market, and to withdraw them in gold. Some of this money is money temporarily remitted to us; a great part of it is money raised on our credit, repayable after a certain period, but at any given moment withdrawable at notice. If our foreign creditors all want to be paid in gold at the same time, we should be unable to do it. Luckily, such a contingency need not even be contemplated, except on the outbreak of a serious war. Given time, we could pay our debts even then. The question is whether we should be given time.

What, then, is likely to happen on the outbreak of such a war? Suppose, for instance, Germany declared war against us. A crisis in the money market would be at once precipitated. Everybody would be seeking to place themselves in a position to meet their engagements. Money would dry up, and the Bank rate would be forced to a high figure. At the same time there would be a tremendous fall in value of all securities on the Stock Exchange, so great a fall that the Stock Exchange might even have to be closed. Banks would have to "carry" their customers who had borrowed against securities, and would find a large part of their assets unrealizable. The discount market, i.e., the bill market, would be no better off. Business would be at a standstill, paralysed by suspicion. The value of a bill depends on the soundness of the "names" on it, and there would be no firm which might not be unsound in such a time. Our foreign clients, too, might in many cases have

great difficulty in remitting us "cover" for the bills falling due accepted on their account. In the case of Germany itself, there would be some doubt whether we should be able to obtain payment at all. Under the English law war cuts off all intercourse between the subjects of the two countries at war, the payment of all debts between them is suspended until after the end of the war. Presumably the German law is not very different. It would appear, therefore, that the only way of settling outstanding debts between citizens of the two countries would be for these debts to be assigned to third parties, or money remitted through third parties. No doubt all respectable houses would do their best to meet their engagements in one way or another. The question is rather whether they could do so.

London finances Germany by means of acceptances to the extent probably of about £70,000,000 sterling at any one time. This means that accepting houses in London will have made themselves responsible during the two or three months after the outbreak of war for the payment, mainly to the Joint Stock Banks, of £70,000,000 against bills drawn on German account, which these banks and others will have bought in the discount market. But the accepting houses would only be in a position to pay the whole of this large sum if they receive, as they would in the ordinary course of affairs, the same amount from their German clients, to finance whose business the bills were drawn. It is quite probable that these clients would not or could not pay. It is probable that in any case, whether their money were received or not, the discount market would be so hopelessly disorganized that a "moratorium" would have to be declared. Otherwise every one would be compelled to call in his loans and liquidate his position in order to find the means of payment and, as every crisis has proved, that course would be fatal. The whole credit system rests on the supply of banking currency. If this currency is withdrawn no one can meet his debts, because no one has the means to pay. The whole money market would be struck with paralysis. As Bagehot said, all that would be left would be a mass of failures and a bundle of securities. In any case the sudden stop of the discount machinery would cause incalculable damage and

confusion to trade and enterprise throughout the world. There is little doubt that in order to prevent internal demands from exhausting the Bank's resources the Bank Act would have to be suspended and a free issue of bank-notes legalized. But bank-notes are no good as an international currency, and everything therefore would depend on the action of our foreign clients as a whole. If they took fright and demanded immediate payment in gold, London might have to put up her shutters as a free gold market, simply through lack of time to save herself by the realization of some of her immense assets abroad.

We may hope, indeed, that matters would develop differently and that most of our foreign creditors would behave decently and would do everything in their power to help us. In addition to the great risks of gold transport there would be every reason why they should, just as there is every reason why an ordinary depositor should do his level best not to embarrass his own bank. The surest way of his losing money is for his bank to be compelled to close its shutters. So if London put up her shutters as the bank of the world, heavy loss and confusion would fall on all these countries, which utilize her services and whose credits and advances would not be renewed. It is hard to exaggerate the difficulties into which the whole financial world would be plunged, or to foresee how London's place could be filled. Confidence is a plant of slow growth, and no other centre possesses that combination of qualities that has given London her pre-eminence.

It has been suggested that if we were at war with Germany, the Germans might not shrink from the most extreme action in order to damage us, and withdraw, for instance, in gold all the money they had in London available. It is doubtful whether they would or could do so. In the first place, as stated above, the English law would forbid Englishmen to have any intercourse at all with Germans. Furthermore, their power to withdraw money would depend on the proportion of our liabilities to them compared with theirs to us. It implies, moreover, a concerted action on the part of all or most German firms. Presumably the gold withdrawn would be liable to capture, at any rate unless the transactions were carried out

through some other nation. And, lastly, any such action if successful would damage Germany almost as much as ourselves.

It is certain, for instance, that a first-class war would of itself deal a heavy blow to Germany's trade and finance, because, if it is bad for a creditor not to be paid, it is still worse for the debtor not to be able to renew the loans, without which he cannot continue his business. That blow would be repeated with redoubled force in the world-crisis which would follow the destruction of London's credit system.

Behind our foreign creditors are our millions of depositors. How would they act, if the withdrawal of gold by our foreign creditors threatened completely to empty the vaults of the Bank of England ? Would they still retain complete confidence in the value of a bank-note ? In 1907 depositors in the United States hoarded many millions of gold. A supply of £200,000,000 was found quite inadequate to meet the demands. In previous internal panics in England the Bank's reserve has been reduced almost to nothing in a few hours.

The disappearance of the Bank's reserve would mean a temporary collapse of our banking system. The very extremity of the situation might bring its own remedy. People would be compelled to continue carrying on their business by means of cheques, or some emergency currency, simply because there would be no other means of carrying on life at all, even though they knew it was impossible to get gold if it were required. Nevertheless, the collapse of credit would be a tremendous blow to industry. To high prices and a food famine would be added a great mass of unemployment, which would seriously hamper us in continuing the struggle. From the purely banking point of view the fact that bills on London would no longer be unquestionably convertible into gold would be a great shock to London's position. Such bills are held all over the Continent by the great banking institutions, because they are as good as gold. It would be long before confidence in them was again restored and meanwhile London's rivals might have begun to establish themselves in her place.

Our safety therefore depends on our being given a breathing space to adjust ourselves to the new conditions. If time is given there is no doubt that London has the power to draw all

the gold she wants from other countries. The Bank of England authorities have recently said that, so far as the Bank's experience goes, the raising of the Bank rate to a sufficient level, which means, in other words, that money can be employed more profitably in London than other centres, never fails to attract gold, provided the higher rate is kept effective. It acts both to prevent gold leaving the country and to attract gold to it. The floating supply of money in the great centres is attracted towards the highest rates as certainly as water flows to a lower level. Sometimes the stream does not flow freely at the start. The central banks of the Continent are loth to part with their gold and sometimes make difficulties until the rate in London has reached a figure which threatens disturbance to their own financial position. Yet gold comes more easily to London than anywhere else, as was apparent in the American crisis of 1907, the greatest external strain to which the Bank of England has been subjected. America in her eagerness for gold was drawing millions from London, and if London could not get it from elsewhere her position would become serious. But she did get it from elsewhere. The Bank rate was gradually raised to 7 per cent, and gold flowed in from twenty-four different countries. The flow of gold was aided by a recognition on the part of the leading continental authorities that London's cause was their own, and that they must come to London's aid if they wished to save their own skins.

In a war crisis, however, to raise the Bank rate might not be so effective, since a distrust of London's capacity to hold out might be prevalent, and since no one would care to risk sending gold there. Moreover, it is to be remembered that London might be deprived of the South African gold, which might easily find Paris or New York a safer destination. At the same time the assets of the British nation abroad are so immense that if they were under the necessity of realizing them, it is difficult to suppose they could not draw gold to London. They might not even have to realize these assets ; it might be enough simply to stop the export of capital. Gold would flow in then to pay for the interest on our present investments, which amounts to something like £180,000,000 per annum.

The most dangerous period, therefore, will be the few days or weeks after the declaration of war, or if it was quite clear war was inevitable the few days before that declaration, when our enemies might attempt to withdraw as much money as possible. What happens will depend upon the coolness of our own people, and the view which foreigners take of our strength. If we are defeated a financial collapse can hardly be averted. So long as we are reasonably secure against defeat we ought with luck to be able to pull through, shaken no doubt, but not permanently damaged. If we are victorious, we shall have ample time to convalesce. It is hardly necessary to draw the moral. The British fleet is the best protector of London's gold reserve.

III

If the foregoing analysis is at all correct, the development of the financial crisis that an outbreak of war must bring would depend on the way it was met at the outset. A few millions, more or less, might make the difference in our ability to meet it without the necessity of suspending cash payments. If, therefore, our reserve of gold is, as is generally admitted, rather uncomfortably small, there would seem every reason to insure ourselves more securely against risk by increasing it. The Bank of France holds gold to the amount of £128,000,000; the Bank of Russia, £125,000,000; the Reichsbank, £55,000,000; while the Bank of England, with world-wide liabilities, has only £35,000,000.

The size of our reserve is not the result of design, but of accident. In 1844 Parliament, impressed by the evils of an over issue of bank-notes, practically limited the privilege of issue to the Bank of England, and determined that the Bank should not issue any notes over a certain amount (now about £18,000,000), unless gold to an equal amount was deposited in its vaults. Bank-notes were then the basis of credit, and Parliament wished to clip its wings. It is not worth while now asking ourselves whether that act was wise or stupid. But it is worth while noting that, though originating in profoundly different conditions and in course of time wholly nullified in its intentions, that Act is the sole regulator of the

size of our gold reserve to-day. It was not long before the City discovered a means of circumventing the intention of its authors. Cheques took the place of bank-notes, and though credit liabilities under this new system soon far exceeded those under the old, the law was silent as to maintenance of an increased reserve. If the cheque had not been invented, and we had been restricted to bank-notes, a huge reserve would have by this time been stored in the Bank.

In other countries, in France, Russia and Germany, the gold reserve is also, as in England, based on the note issue. It is much larger because notes are still used and not cheques. In England, the note issue, though still regulating the reserve, has ceased to bear any important relation to the amount of credit. But, while the size of the reserve is thus determined by an obsolete law, that law has completely failed to determine how much credit shall be manufactured on the basis it lays down. It prescribes the size of the foundations, but sets no limit to the superstructure. The Bank of England determines the amount of credit to some degree, but to a much greater degree the other banks, large and small, and with them the accepting houses. For the banks, as we saw, supply the currency in the form mainly of book-credits, against which cheques may be drawn. The overwhelmingly greater proportion of money transactions in England are settled by means of cheques and bills. Bank-notes are negligible as currency, and perhaps not more than 1 per cent of our daily business is settled in gold. Now every credit or advance given, since it creates, somewhere or other, an equivalent deposit, creates, equally, a possible claim against the gold reserve, and thus the responsibility for maintaining an adequate gold reserve—or, more correctly stated, for seeing that the manufacture of credit is kept within reasonable bounds—rests with bankers, large and small. Diffused responsibility is never felt very keenly, and it is somewhat disconcerting to find that while nearly every leading banker will admit that credit is often manufactured too freely and that our cash reserves are not as large as they should be, the banking community, as a whole, does not seem inclined to adopt the obvious remedy. That remedy is that the banks, as a whole, should either reduce their credit liabilities or

increase their cash holdings. Other specific remedies have often been suggested, the repayment by the Government to the Bank of its debt of £11,000,000, the origin of which dates back to William III ; the issue of £1 notes ; the maintenance of a cash reserve by the Post Office Savings Bank. Some of these would certainly help. But most important of all is the recognition by the banking community as a whole that, if credit, as they say, has outrun gold, the true remedy lies to their hand.

The difficulty is that it is nobody's business in particular to take the first step. We have "drifted" down this stream, as down so many others, and with such brilliant success hitherto, that we may be lulled into a false security. In normal times the credit machinery does certainly work extraordinarily well. It is a marvel of economy, delicacy, and elasticity. The question is whether it does not work too well. If we tried, we could no doubt in times of peace make it a still greater marvel of economy and delicacy, and work with a still smaller reserve —just as a man may, for many years, defy the risks of fire and accident. But nobody supposes we should be wise to do so. Our danger, as we have pointed out, is that a crisis may bring a sudden and unbearable strain on our liquid resources, without giving us time to realize our immense assets. It is not suggested that any system adapted to peace can be wholly satisfactory in war. We might as well live under perpetual martial law in times of peace. But there is at least a case for minimizing our risks. And if, despite their misgivings, bankers will not, or cannot, make up their minds whether anything ought to be done, it is the duty of the Government to make a careful inquiry into the matter. Legislation is indeed too clumsy an instrument for our needs. What is needed is a full investigation as to the best means of quickening the banking and financial community, as a whole, to a sense of their responsibilities, and of preparing the Government for such steps as they may have to take on the outbreak of war.

IV

It is clear that every country having commercial or economic relations with Great Britain would suffer seriously in the general

welter of confusion brought on by a collapse of credit in London. The closer their relations, and the more dependent they were on London for capital, the worse would be their state. No countries would suffer more than the British Dominions beyond the Seas. This hard fact, of which there can be no doubt, runs counter to some comfortable doctrines somewhat widely held in those countries.

There are a large number of people in all the Dominions, except South Africa, who regard war as an anachronism, indulged in only by mediæval European nations, and easily to be avoided by the exercise of a little common sense. They are led on to the comfortable belief that, since it is foolish to fight, and since Europeans are, after all, reasonable people, therefore there is no danger of their fighting. And in any case, they conclude, no great harm can come to those who live on the other side of the ocean. Might it not be as well to let the old world settle its differences by itself ?

This is a comforting but vain belief. Any nation which thinks that by determining to take no part in war it will be unaffected by its consequences, is living in a fool's paradise. You cannot eat your cake and have it. You cannot both belong to the modern world and not belong to it. A nation which enjoys the advantages of international trade and credit, cannot at will cut the threads which bind it to other nations. No Dominion can hope to escape serious damage if Great Britain is hard pressed in a great war. Their trade is very largely—in the case of all except Canada, preponderately—with England. Just like other countries they treat London as their banking centre. All their big banks have branches in London. They keep a great deal of money there. They borrow London's credit. Their own banking system is largely dependent on London ; their means of financing their imports and exports almost wholly so. The large supply of new capital which London gives them yearly is to Canada its life-blood and to all of them of great importance. The majority of them have few resources of their own to fall back upon. It is not indeed necessary to presuppose any such disaster as the defeat of our navy to see that the Dominions must suffer with us in time of war. They must suffer with us whatever our fortunes.

If we are victorious, their troubles may not last long. But they will grow more acute the more uncertain become our prospects. A first-class war is bound to bring with it, at best, a great dislocation of trade, a great restriction of credit, and a great destruction of capital. The worse matters go for us, the worse will the machinery be thrown out of gear. Not only will the dislocation of our trade and our financial system dislocate those of the Dominions too, but the springs of capital will dry up. London will have no money to spare them and it is doubtful whether, at such a moment, other countries, not excluding even the United States, would be able to fill London's place. New countries which are rapidly expanding always suffer from trade and monetary depression more than old ones, just as an unfinished house is bound to suffer if the money gives out before the roof is on.

Capital in a new and expanding country is not spent to provide for the population that is already there, but for the population that will be there. Railways and roads are built, shops and stores opened, townships laid out, and factories equipped far beyond the needs of the existing inhabitants. Prices for land rise quickly. A general optimism prevails and the future is gaily discounted. But the whole structure depends on a constant supply of capital. Unless the expenditure of capital goes on, great numbers of men will soon be out of work. And if there is no work to do, the expected immigrants will certainly not come. And if they do not come the railways and factories and stores will not pay, and the speculators in real estate, at inflated prices, will be unable to hold on to their property. Pessimism will succeed optimism, and depression will be proportionate to the height of former expectations. It will be intensified if, at the same time, their banking system is deranged, the chief market for many of their products stagnant, and their commerce the prey of a hostile fleet.

Naturally the Dominions would not all suffer equally. Australia is more self-supporting in the matter of capital than Canada, and for reasons which do not concern us here, her rate of progress is markedly slower. South Africa and New Zealand have given fewer hostages to fortune. In the last three years Great Britain has raised, by means of public issues

in London, irrespective of capital employed privately, for Canada, £103,000,000; for Australia, £29,000,000; for New Zealand, over £7,000,000; and for South Africa, £30,000,000. From the figures given on page 16, it will be seen that Great Britain has invested in the Empire no less than £1,652,000,000, of which Australasia has taken £395,000,000 and Canada £365,000,000. This is probably a conservative estimate. And Great Britain has not only provided this mass of capital, but provided it on more generous terms than she has afforded to any other borrower. Sentiment has led the British people to supply their own fellow-subjects oversea with money at least 1 per cent cheaper than foreign countries, and Sir Edgar Speyer calculated recently that the annual interest saving to the Dominions and Dependencies is at least £10,000,000, a very handsome preference. In other words, for the same payment of interest these countries have been able to raise £250,000,000 additional capital. Moreover, to the detriment, be it said, of Consols, Great Britain has added to her list of Trustee Stocks about £650,000,000 of Colonial and Indian Stocks and thus enabled the Dominion, Provincial, and State Governments of the Empire to raise money on far more favourable terms than would otherwise have been possible. When questions are raised as to the return which Great Britain gives to the trade preferences of the Dominions, the enormous advantages the latter gain by the preferential treatment of their issues, both by the people and the Government of Great Britain, should not be forgotten. If some great convulsion checks the flow of capital from Great Britain no other lender will be found from whom such terms can be obtained.

It is clear, therefore, that in their measure every British Dominion would suffer with Great Britain, and it would seem that, even if no loftier motives swayed them, self-interest alone should lead them to spend every penny they can afford on placing beyond question the supremacy of the British flag at sea.

Yet there is a risk lest both the danger itself and its nature should go unrecognized in the Dominions. In those far lands the very idea of war has become unreal. Sheltered by the British flag from the pressure of hard facts, remote from the

conflict of nations, these favoured communities have forgotten that a nation may still be called upon to fight for its liberties and its place in the world, and even for its very existence. War, they say, is obsolete. Are they so certain about it? Aré there no causes for which even the most up-to-date and reasonable nations would draw the sword? Would the Australians confine themselves to protest while the Chinese landed in their millions in the Northern Territories, or Canada be content merely to reason while the Asiatic flood poured into British Columbia? No attempt has been made in these pages to minimize the lamentable effects of a great war on the material well-being of the nations involved. In modern times both victor and vanquished must suffer heavily. But while considerations of material loss will, and should, weigh heavily against war, they will never be decisive. War threatens the world still, because its nations are still rooted in the past. There are still profound differences of language, tradition and ideals even between the nations of Europe, while between the black, yellow and white races are gulfs which may never be bridged. In each nation these forces of language, tradition and ideals are fused into a national spirit, for which in the English language there is no word nearer than patriotism, but which the Germans call *Deutschtum*, that national idea for which every good German is taught to die. So long as these deep national differences persist, so long is there a danger that they may clash in their effort to live and to expand. Some day they may be merged into a wider patriotism, but that day will not come in our time.

War, then, is not all a matter of pounds, shillings and pence, and the problem is not wholly solved when you have shown that every war must leave both sides poorer than they were before. Does England grudge the money which Chatham spent on the conquest of Canada? Germany did not fight France in 1870 to make money, but to become a nation; the ideals for which Garibaldi fought are none the less splendid because they cannot be weighed in a balance sheet; neither the Northern nor the Southern States of America hesitated in 1865 to defend principles which they held sacred, nor were deterred by the reason, unanswerable in logic, that war must

inevitably involve incalculable material loss. Japan did not fight Russia in 1905 because she believed Korea would be a profitable possession, but because she felt, rightly or wrongly, that Russia, established across the narrow sea, would cramp the freedom of her national life. England did not fight in South Africa in 1899 because she thought that the Transvaal and the Free State would pay their way, but because she could not in honour desert her own people and because she deemed it of vital importance that British freedom and British institutions should not vanish from that wide land. The Boers loved their own customs and institutions with equal intensity. It was a clash of national wills and national ideals not to be avoided. The Germans are sore now because they feel that *Deutschtum* has not got its fair place in the world. They want colonies, not in order to make money out of them, but in order to spread German civilization, which, in their eyes, is more valuable than anything else in the world. If the British people had been wholly guided by reason, they would no doubt have hesitated as to whether the life of even Gordon was worth the millions spent on the expedition to relieve him. But they knew they would have been dishonoured, had they counted the cost. It is well for us to remember the tremendous liabilities in which war will involve us, so that we may soberly weigh the issues involved and make sure that they are vital. But when they are vital, the cost will weigh light in the balance against the maintenance and defence of the British realm.

II

LOMBARD STREET IN WAR

(September, 1914)

I

The brief and very incomplete financial diary given at the end of this article, unintelligible though some of its contents may be to the layman, affords nevertheless some indication of the profound and far-reaching disturbance caused throughout the financial world by the great European war. The time is not ripe for a thorough examination of the crisis in all the money centres of the world and of the varying methods adopted to meet it. All that is aimed at now in these pages is to give a short account of what actually happened in London. There is no little difficulty in doing this clearly as well as shortly. For finance, like philosophy, has an unintelligible language of its own. Moreover, the mechanism of the City is in actual fact very intricate and complicated, difficult to grasp as a whole and still more difficult to expound. Hardly a statement can be made that ought not to be qualified in some way or other, if exact truth is to be attained. But this is quite impossible within the space of a few pages. The picture given will therefore be painted only with the broadest of brushes.

London is the financial capital of the world, the world's bank, the world's clearing house, the world's greatest Stock Exchange, the only free market for gold, the greatest lender of money and credit. All the world owes London money. London therefore must be more affected by a world-wide crisis, and a world-wide financial and commercial paralysis, than any other centre. Other centres will have suffered very severely, but in no other case is the whole world so vitally affected.

Perhaps the City's most outstanding feature is that it is the greatest manufacturer of credit in the world. In the modern world all transactions which are not conducted by means of barter, or by the actual exchange of gold and silver against goods or securities—and these are of course infinitesimal in proportion to the whole—are carried through by means of credit. By means of the invention of joint stock banks, limited liability companies, stocks and shares, bills of exchange and so forth the wealth of the world is liquefied, mobilized, concentrated, divided into convenient shares, and passed from hand to hand and from country to country through the great monetary centres of the world. The titles to wealth, whether they be a deposit account in a bank, on which one may draw cheques, or a bank-note, or a promissory note, or a share, or a bond or a bill of exchange, are not real wealth in themselves, but merely represent it. But they enable wealth to be dealt with, handled, borrowed and lent, and it is on the security of these titles to wealth representing the wealth underlying them that the banking community lends money. The lender never lends except on the assumption that the borrower has or will have the means to repay with interest, and in the vast majority of cases the borrower must give some security or other as evidence of his ability to repay. Thereupon he obtains "credit" from his bank. In other words, the bank gives him the right to use some of its resources. These resources it obtains through the invaluable function the banking community performs of concentrating all the scattered wealth of the country which private individuals and companies deposit with them. It then lends them out to those who in its judgment can utilize them to the best result and can offer the best and most liquid security and the surest guarantee of repayment. The enormous credits in the way of loans, discounts and advances granted by the banking world to all and sundry are possible only through the enormous deposits made with the banks—amounting in the case of the British banks to over £1,000,000,000. This wealth is not left lying idle in the banks' vaults. It is utilized in the way of loans and purchases of securities of different kinds. It may be loaned against stocks and shares representing wealth in the

form, say, of a railway in the Argentine or a brewery in England, or the taxing power of the British Government as represented by Consols, or a steel company in Canada, or against bills of exchange representing wealth in the form of merchandise, such as grain from America or coffee from Brazil or silk from Japan. The forms of wealth on which banking loans are secured are as endless indeed as the variety of things in the world which are useful and therefore valuable to mankind.

Now, since the depositors of a bank may at any moment require their money back, it is obviously of first-class importance that the loans which a bank has made should be repaid whenever required and that the securities which it has bought, whether they be shares or bonds or bills of exchange, should be easily liquidated and turned into cash. Unfortunately, the very fact of a crisis means that to turn anything into cash becomes difficult, and a severe crisis means not only that it is impossible, but that for a bank to try to turn its assets into cash only aggravates the crisis. You can only turn your holdings of securities and bills of exchange into cash if some one else will buy them, and in a crisis no one else will buy them. You can only get your loans repaid if your debtors get their loans repaid or can liquidate themselves by getting some one else to buy the securities or assets which they hold. That is just what no one in a crisis will do. A bank may make loans on call to the Money Market, which at ordinary times it rightly treats as equivalent to cash. It is repaid on demand in all ordinary times without question. But in a crisis the Money Market cannot repay it, because it cannot sell its bills. If the bank insists on repayment, the debtor must go into default, and then the bank is worse off still. It has not got its loan back, and it has caused a failure which may have the most far-reaching consequences, both for itself and for all other financial institutions. In a crisis all the devices of credit for making wealth liquid fail. The whole system of credit is based on the assumption that things will go on normally, that every one's business is conducted on reasonable anticipations of profit, that every one will pay every one else at the due date. It is based on confidence. If a war breaks out,

then every one knows that all calculations are thrown out, that all anticipations of profit or of every one paying their debts at the right time are certain to be falsified. All confidence is destroyed. The destruction of confidence, even if there is no justification for it, is sufficient in itself to bring the machinery of credit to a stop. No one then likes to buy or loan against the usual evidences of wealth, since no one knows in such times what they are worth—i.e., whether any one will buy them or, if they can be sold, at what price or what real wealth is at the back of them.

It is easy to see why this must be so. In normal times the titles to wealth, such as stocks and shares, bills of exchange and so forth, which are dealt with in the City, do normally represent the actual wealth to which they lay claim on their face. Yet even in normal times all securities go up and down in value. A change of fashion, a bad harvest, over-expansion, an excess or lack of capital, a wrong estimate of the profitableness of a particular industry, all these and many other causes—in a word, everything affecting supply and demand—produce a rise and fall in the prices of securities because they affect the value of the wealth which these securities represent. Some affect a single industry. For instance, a sudden fashion for furs will send the price of a fur company's shares up. Others affect industry in general, such as lack of capital throughout the world. But normally these changes are foreseen and work within comparatively narrow limits. But not so in a prodigious catastrophe like the present war. Then every estimate is upset. No one knows what is the value of the titles to wealth he possesses. He only knows they are probably worth less than before. Some few, such as the shares of armament firms, or khaki manufacturers may be worth more. But in the mass securities must be worth less, because there will be less wealth. Not only will there be an enormous destruction of wealth, but, even more important perhaps, there will be an enormous diminution in its production and a world-wide dislocation in its transfer from producer to consumer. It is impossible therefore to say what securities are worth. Take the shares of a cotton estate in the Southern States of America. That industry is faced with tremendous losses owing to the fact

that its market on the Continent of Europe has suddenly ceased to exist. Take again the shares of an American or Australian copper mining company. The market for copper has collapsed. The production in America has been cut down to about 25 per cent. The copper mines in Australia have been shut down. Take again the shares of a railway under construction in some new country, say the Argentine or Canada. If it is to be completed, it must have more capital. Yet Europe is the only place it can get capital from and that is now impossible. These are merely examples. But there is practically no industry in the world which is not already more or less affected by the war. In consequence every one is uncertain of every one else. Have they locked up their capital in securities, which must now inevitably fall immensely in value? If so, they may not be able to meet their engagements.

How does all this affect the ordinary depositor? He probably owns some securities. He knows they have shrunk enormously in value and he begins to cast anxious glances at his bank balance. He knows his bank invests its money in all sorts of things, advances, bills and securities, and he wonders whether they also must not have shrunk greatly in value. He wonders whether it might not be better to draw his money out. It crosses his mind that even a big joint stock bank might fail. Of course it might fail, and the one absolutely certain way to make it fail, whether in good times or bad, would be for depositors to try to withdraw their money. No bank, whether in good times or bad, can possibly pay out anything like all its depositors at the same time. For depositors to begin drawing out their money is an absolutely fatal and suicidal course. They have only to sit still, and their money will be perfectly safe. They have only all to try to draw it out and they will all lose it. Of course even English joint stock banks will have losses, and heavy losses; but their securities are the best in the world, and their losses will certainly not be greater than they can stand, if they can liquidate their assets at leisure. It is without doubt true to say that even to-day the total assets of all the banks, merchant bankers, and discount houses in London, i.e., all those institutions which together comprise the Money Market, a long way exceed their

liabilities. What the City requires is time, and plenty of time, to work out its salvation. To try and force matters in the middle of a crisis is the most fatal of policies.

Every one in business owes and is owed money, has assets and liabilities. The whole business and financial community is tied together by the nexus of creditor and debtor. It is like a pack of cards. If one large debtor, on whom the whole community counts to pay his debts, in order that they may be able to pay theirs, "falls down," they all may do the same. One big failure may have incalculable consequences. It is like throwing a stone into the middle of a pond. The ripples widen out, until the whole surface is covered. If the crisis is a purely financial one, and proper measures are taken, confidence is not long in returning and the working of the machinery may soon be normal again. But a great war, involving the universal dislocation of trade and business relations, and an enormous destruction of wealth itself, is a very different matter. The huge dislocation of finance and commerce, the foreknowledge of the enormous resulting destruction of wealth, the complete failure of confidence are of themselves enough, even before a life has been lost or a gun fired, to bring the financial machine to a dead stop. No one knows how he or any one else will be affected by the war, or what his position will be at the end of it. He does not know if some at least of his debtors, whether in this country or abroad, will ever be able to pay him, or if so, when. All business is based on the possibility of making fairly close estimates of the future, and in war no one can make any estimates. No one knows therefore who will be able to stand the strain of war, and all business is paralysed by suspicion and doubt. No one knows how much loss his existing liabilities may cause him and no one therefore wants to contract new ones. But no business can be done without contracting new liabilities, and old liabilities cannot be liquidated without continuing to do business. A thorough crisis means therefore a complete deadlock. No more striking proof of this could be found than the actual course of events in London during the last days of July and the first days in August, 1914.

II

The present crisis has come on the top of a long period of unrest and depression, unrest due to the Balkan wars, rumours of greater wars, tension in Europe, revolution in Mexico, depression due to overtrading in Canada, the Argentine, Brazil and other new countries. All this had seriously weakened some financial centres and especially Paris, though, on the other hand, it had had its good side in reducing speculation to a minimum. On the top of all this has come the staggering blow of the Austrian ultimatum to Servia and its tremendous consequences.

Such a blow the modern international system of finance is quite incapable of withstanding. You can invent no system of credit delicate and intricate enough for the world to-day which can possibly work in a war of first-class importance as well as in peace. The consequences were immediate. In a few days practically every Stock Exchange and Bourse in the world was closed; the whole international money market was paralysed, and with it the world's foreign trade; it was impossible to remit money from one country to another; the Foreign Exchanges reached unprecedented figures; gold, the last form of payment possible, could not be shipped for fear of capture, and the assets of the banks in the form of loans to the Stock Exchange and the Money Market and of holdings of bills were completely immobilized; depositors began to show signs of withdrawing their deposits and of hoarding gold; and currency began to grow scarce. Fortunately, in England at any rate the public remained quite calm; immediate and drastic remedial measures have been taken, and though the City has hardly yet begun to recover from the extreme weakness of a sudden and dangerous illness into a state of convalescence, and though normal times are many months off, there is no longer reason to fear any serious relapse, provided the operations on land and sea are in the end successful for us.

It has been shown already that the basis of the great financial superstructure in the City—as in other financial centres—is formed by the numerous joint stock banks and in particular

the great English joint stock banks with their millions of deposits. It has also been shown how essential it is for the banks to invest their depositors' money in liquid securities, and yet how a really severe crisis "freezes up" every kind of asset. It is necessary now to examine in more detail exactly what happens.

A very large part of their resources the banks devote necessarily to the development of industry by loans to industrial companies of every kind. These are the least liquid of their assets and in them the City itself is not directly interested. But the bulk of the remainder are utilized in the City itself, either in the Money Market in Lombard Street, or in Throgmorton Street on the Stock Exchange. In the latter cases the loans are made to stock-brokers and jobbers, and in the former to the discount houses and bill-brokers, who are the middlemen of the money market. For the money market and the discount market are composed of the banks themselves the great merchant bankers or accepting houses and the discount companies and bill-brokers, and it is here that the nerve centre of credit is to be found, the machinery by which the world's trade is financed.

The loans made by the banks to the Stock Exchange amount probably now to about £50,000,000 or something over, and in times of speculative activity rise much higher. The loans at call to the discount houses and bill-brokers may be estimated at not less than £100,000,000 on the security of bills of exchange, and in addition the banks have actually purchased and hold bills of exchange to the value of not far short of £200,000,000. No accurate figures are obtainable, but it is probable that these figures are not far from the truth. It is clear therefore to how great an extent the work of the City is conducted by means of the resources of the joint stock banks, and how vitally affected they must be by the stability of bill-brokers, stock-brokers, and jobbers to whom they have lent money, and of the great accepting houses, who are liable to redeem the bills of exchange which the banks have purchased or hold as security.

It is clear, too, how unpleasant is the position when all these assets, these loans and bills, which the banks are accustomed

to regard as only less liquid than their cash, become "frozen" by a financial crisis in the manner described below. On the approach of any such crisis the banks are tempted to call up all their loans. If they call all their loans, the discount houses, the bill-brokers and the stock-brokers will be ruined, and, if they are ruined, the joint stock banks would be in little better case. Such a policy therefore, as every crisis has shown, is not only impracticable but suicidal. There was some indication in the recent crisis that some banks at any rate did not fully appreciate this fact.

The Stock Exchanges of the world were the first to feel the effects of the coming hurricane. As soon as the Austrian ultimatum was delivered, prices fell heavily on every Bourse on the Continent and in London and New York. As the crisis developed, there came from the Continent an avalanche of sales of American and international securities in the two latter markets. Quickly every Bourse on the Continent, though its doors may have not been actually closed, practically ceased working. London and New York were the only markets in which sales could still be freely made. Prices fell more and more rapidly, and, though London played its part manfully, the growing acuteness of the crisis brought the inevitable sequel. For the first time in its history the London Stock Exchange closed its doors. New York followed suit the same day. Only in this way was universal ruin on the Stock Exchanges averted. Unless it is checked at its outset, a crisis of this character gathers speed and momentum, just as certainly as a steam engine let loose down a steep hill. In an ordinary crisis the trouble can soon be diagnosed, localized and dealt with, but an Armageddon is unfortunately not a local trouble.

It has been stated already that the work of the Stock Exchange is carried on largely on money borrowed from the bank to an extent, at this moment, of probably not less than £50,000,000. Such loans are perfectly legitimate. If there is to be a free market in stocks, jobbers must carry a "book." They cannot do this with their own capital. Accordingly they borrow from the banks. Furthermore, brokers and others borrow money against good securities, which they may be

carrying for their clients. In times of rising markets, too, a great deal of money is employed to finance speculative accounts. All these loans are made against good marketable securities "on margin." Suppose, for instance, that a man has £100,000 of Consols. If the market quotation for Consols were 75, these Consols would be worth £75,000. The owner wishes to raise a loan on them. A bank will require, say for the sake of example, 10 per cent margin, which is the usual margin demanded for Stock Exchange loans. It will therefore only lend him £67,500, the margin being the security required by the bank against a possible fall in value. If Consols were to fall, say, 5 per cent, the borrower would be required to put up an extra 5 per cent of security to keep the "margin" of 10 per cent intact. It is clear, therefore, that with every fall in values on the Stock Exchange, the borrowers, i.e., the brokers and jobbers, must find more "margin." This practice is universal in the case of all Stock Exchange loans, and accordingly a general fall in prices means that an enormous sum in margins must be provided. If Stock Exchange loans were to amount to £50,000,000 and there was an all round 10 per cent fall, £5,000,000 more margin would be required. Unfortunately, too, the process is cumulative. When the borrower's liquid resources are exhausted, to reduce his loans he must sell such stock as he can, and in so doing still further forces the prices down, so that the margins of all those who have borrowed on that stock "run off" still more quickly. If he has no longer anything to sell or is at the end of his tether, the bank can then take his securities and sell them itself to repay, so far as it can, its loan. These forced sales induce a further fall, and so on. Moreover, as each broker fails, he involves in his fall all those to whom he is liable, and if the process continues unchecked, the end is universal failure.

In the present crisis this process was hastened by all the world trying to sell in London and by the fact that brokers dealing with the Continent and with America were unable to get the remittances due to them owing to the paralysis of the Foreign Exchanges and the consequent impossibility of sending money from one country to another. It will be long before normal dealings can again take place on the Stock Exchange. So

long as the Continent owes large sums that it cannot pay and so long as London would have to meet the selling of all the world, it will be useless to resume ordinary business. Nevertheless, if the war progresses satisfactorily, gradual steps will no doubt be taken to resume business.

By the closing of the Stock Exchange one important class of what are generally regarded as the joint stock banks' liquid securities was "locked up." It was impossible for them to call in their loans from brokers and jobbers. The latter can only pay if they can liquidate their holdings or borrow from elsewhere. That obviously they cannot do.

Meanwhile a parallel process was at work in the Money Market, the smooth working of which is still more vital to the country and the whole world. It is hardly too much to say that by means of the London Money Market the world's trade is financed. The commerce of the world—food-stuffs, raw materials, manufactured goods, metals, coal, oil, every conceivable requirement of civilized and uncivilized man—is being carried without ceasing over all the oceans and seas from country to country. The sellers of these goods cannot usually afford to wait for the money due to them throughout the interval, sometimes short, sometimes long, between the time when the goods are bought from the producers and shipped and the time they reach their country of destination and are sold and paid for by the consumers. The capitalist accordingly finances the goods during that period through the medium of bills of exchange, which run for an average of about three months. A full explanation of what a bill of exchange is would need an elaborate disquisition. It may suffice to liken it to a cheque, but a cheque which will not be paid for three months. Suppose A were to give B, to whom he owed money, a cheque payable three months hence. B would take it to the bank on which it is drawn. The bank, instead of cashing it, would undertake to pay it three months hence by writing its name across it. B could then sell it to C, or in other words discount it with him and obtain his money, because the bank's promise to pay would be a perfectly good security and C would be sure of his money at the end of three months. At the end of that time, therefore, C takes it to the

bank to be paid. A meanwhile, during the three months' period, would have provided the bank with funds to meet the cheque. That is a very rough comparison with the discount market. A is the drawer of the bill, say a shipper of grain from New York. B is the party to whom the bill is remitted, say an American bank's agent in London, the bank is the accepting house on whom the bill is drawn and C is the discount market.

A simple example from actual practice may make the comparison clearer. Suppose a grain merchant in Canada is exporting grain to England. He naturally does not wish to wait for payment until his grain is sold in England and the buyer can send him his money back. The period between the time the grain leaves Canada and the time it is sold in England must be bridged over. It is bridged over by the bill of exchange. The buyer of the grain merchant "opens a credit" with some accepting house in England in favour of the Canadian grain merchant. The latter draws a three months' bill on the accepting house for the value of the grain shipped. He sells the bill to a Canadian bank, who will buy it at a discount—representing interest for the three months. The bank will buy the bill because it has complete faith in the ability of the accepting house to meet the bill when it falls due. The bank sends it to its London branch, which presents it to the accepting house for its acceptance. It is then a complete bill, and is either held by the bank till maturity or more probably sold to the discount market. The discount market probably re-sells it to a joint stock bank. Meanwhile the grain is shipped to England, sold, and the proceeds paid over to the accepting house, so as to provide the means to meet the bill on maturity.

London is by far the most important bill market of the world. The world pays and is paid its debts in London. London is the great mercantile clearing house. It may be that hides and rabbit skins are being sold from Australia to New York, or coffee from Brazil to Hamburg, or eggs and butter from Siberia to London, or herrings from Aberdeen to Russia, or machinery from England to South America, or cotton goods from Lancashire to India and Australia. The buyers and sellers settle up their transaction in London. It is no good an American sending American bank-notes to his creditor in Australia, or an

Indian sending rupees to Manchester. Some international currency is needed, and after gold, by far the most common form is the bill on London bought and sold through the medium of the Foreign Exchanges. This great trade in bills is carried on by means of the capital, credit and resources of the merchant bankers, discount houses and the great banks of London. It is estimated that at any one time there are probably in the market upwards of £300,000,000 of bills for the account of nearly every country in the world. This is the sum then that is being lent by London through the bill market at any one time. A very large portion of it, no doubt the larger, is provided to finance the trade of Great Britain and the British Empire itself. But in addition to that, an enormous sum is lent to other countries, and particularly to Germany and the United States. It is to enjoy the unparalleled resources of the London market that all the leading banks in the world have branches in the City, whether they be French, German, Austrian, American, South American, Canadian, Australasian, South African, Russian, Chinese, or Japanese.

The stream of bills from birth to death, through their brief life of drawing, acceptance, discount and redemption, is a never-ending procession. This great mass of bills represents the machinery by which the commercial countries of the world clear their debts to one another. If the estimate of £300,000,000 bills out at a time is taken as correct, then, within the short period of about three months, money to redeem that whole sum must be provided by those who have "accepted" these bills and, by so doing, undertaken to meet them at maturity. The "acceptors" are in the main the large private merchant bankers, and in a lesser degree the banks themselves. Obviously they do not find this great sum only out of their own resources. They can meet it, because those whose undertakings, of whatever nature they may be and in whatever part of the world they may be carried on, have been financed by these bills, remit the money to redeem the bills at their maturity. In the case of true commercial bills, for instance, the money will be provided automatically by the sale of the goods, whether it is grain from Canada, cotton from India or America, rubber from Brazil and so forth. There is thus

a continual process by which enormous sums of money are lent by London to the world by means of bills drawn on London, and enormous sums remitted to London to meet those bills as they fall due. First-class English bills are considered throughout the world as security of the finest and most liquid type. They are held in large amounts by many continental banks, because by merely remitting them to London for sale they can always buy gold with them; they form the second line of defence, after their actual cash, in the assets of the great British joint stock banks. They are liquid because they are so short a security and secured in great measure on some staple commodity for which there is always a market.

This vast and delicate machinery of credit works wonderfully smoothly in normal times. But, if it is to work smoothly, the stream of remittances must continue to flow without check, and the joint stock banks must continue to purchase the bills as they come forward. A sudden stoppage, a sudden blow to credit has the same effect on the discount market as the cutting of a main cable in a great electric power system. The whole system comes to a stop. It required only two or three days, from July 28 to July 31, to paralyse the market completely.

It has already been stated that the whole monetary machine rests at bottom on the great banking resources of London, supplied by the millions of depositors. It is because the joint stock banks have deposits of £1,000,000,000 that they can hold so many millions of bills and lend so many millions more on the security of bills. Every day large quantities of bills are remitted from abroad by banks, merchants and financial agencies of all kinds to their correspondents and agents in London, nearly all of which, in one way or another, find their way eventually to the portfolios of the banks. It is clear, then, that if the banks refuse to continue buying bills, the market must very quickly become disorganized, just as to throw a dam across a river must flood the country above it. Yet on the first sign of serious political trouble the joint stock banks naturally think of themselves. Bills may be very good security. But they are not as good as cash, when your depositors are clamouring for their balances. Accordingly the banks try immediately to make their assets as liquid as possible.

They become chary of buying any more bills ; and at the same time they try to call in their loans from the discount houses and bill-brokers. These latter are at once placed in a most unhappy position. They are middlemen, who hold enormous amounts of bills, partly on their own capital, but mainly on money borrowed from the banks and from financial houses. They can only repay their loans by selling their bills. If the banks refuse to buy their bills, and insist on calling their loans, they cannot but be ground between the upper and nether millstone. Their sole resource then is the Bank of England, which must in any crisis continue to discount bills freely if the position is to be relieved. But since the Bank usually refuses all but quite short-dated bills, and rejects many bills freely dealt in on the market, and since in any case they must suffer heavy loss by the great rise in the rate of discount, an intense crisis, in which the bill-broker's loans are called from them from every side at once, may still ruin them. If they fail, they must spread further disaster round them, just as in the case of serious failures on the Stock Exchange.

It was about July 28 that the difficulties in the discount market began. The heavy falls in prices on all Stock Exchanges, the complete disorganization of the Foreign Exchanges, and the resulting difficulty of sending any money from one country to another heralded the approach of a serious crisis. The banks no longer discounted bills, and began calling in their loans. The discount market was forced to go to the Bank of England, which discounted bills freely on this and the following day, discounting and lending about £14,000,000 in two days. On the following day, July 29, matters grew worse. Every one throughout the world was obviously trying to liquidate his position. The Paris Exchange fell to an unprecedentedly low figure, showing that France was drawing as much money from London as possible ; the New York Exchange was enormously high in consequence of the necessity of New York remitting the very large sums of money owed by the United States to Europe as a result of the great sales of American securities ; the Berlin rate, too, was very high, since Germany is a large debtor nation, particularly to us, and we were no doubt doing our best to get all the money we could from her,

while no doubt she was withdrawing any balances she had in London. The exchanges, in fact, went to such figures that all quotations were nominal and no further remittances from one country to another were possible. On July 31 the Bank rate was increased from 3 per cent to 4 per cent; gold was at a premium in Paris, where the necessity of a moratorium was already recognized; the Bank of England return showed that the reserve in proportion to liabilities had fallen from 52·4 per cent to 40 per cent. What had added to the difficulties of London in these last days had been the heavy demand from foreign countries on the balances they had in London. Before absolute paralysis was reached, no doubt a great deal of money was withdrawn.

The breakdown of the machinery of the Foreign Exchanges brought with it a new feature which would have not accompanied any purely internal crisis, and which affected England to a far greater extent than any other country, for the simple reason that England is the greatest creditor nation. It may be unpleasant for a debtor to be unable to pay his debts; it is much more unpleasant for a creditor not to get them paid, especially if he is a man in a very large way of business with heavy liabilities which he must meet from day to day. The whole world owes very large sums to London. They cannot now pay them; Germany and Austria must wait until the war is over, and the rest of the world at any rate until the exchanges become normal and until the moratoria declared in most of the countries of the world are at an end. The accepting houses, therefore, who have accepted these hundreds of millions of bills on the condition of punctual remittances to cover them are left meanwhile to pay them out of their own resources. Consider what this means. On the estimate of £300,000,000 of bills falling due over a period of three months, nearly £4,000,000 will fall due to be paid every weekday during that period. Of course not nearly all this sum will be for account of foreign countries, because a considerable part will be in respect of goods sold to this country. Nevertheless, the universal dislocation of credit will affect the great bulk of it. It is clear that even the strongest accepting houses would find it difficult to continue to meet for many weeks out of their

own resources these enormous sums. The failure of a single large accepting house is sufficient in more normal times to create a first-class crisis—witness the Baring crisis of 1890. If one great accepting house with millions of acceptances were allowed to go, it would bring down others, accepting houses, discount houses, and even banks, in its train.

The position of the accepting houses is not due to their own fault any more than it is the fault of the banks that they are never in a position to pay off all their depositors at once and that their inability to do so must become more pronounced the more severe the crisis. You cannot possibly conduct the credit business of the world in peace in such a way that it can withstand a universal war. Either the financing of the world's trade is to be done through London or not. If it is, then it entails responsibilities which in time of peace, owing to the essential soundness of the business are negligible, but which must become very serious when circumstances make it impossible for foreign debtors to meet their obligations. It does not matter who does the business. The result must be the same whether the acceptance business is done by private houses or joint stock banks. If it is not done at all, London will surrender its position as the financial centre of the world. If it is done, whether by accepting houses or banks, it involves in each case the same obligations.

By the evening of July 30 it was clear to those who were aware of the position that, war or no war, the crisis was now too far gone to be remedied except by means of the most drastic measures.

The next day, July 31, the day on which war between Germany and Russia became almost a certainty, was a dramatic one for the City. The London and New York Stock Exchanges closed. Very large demands were made on the Bank of England for loans and discounts, the Bank being now the only refuge which the discount market had from ruin. The Bank rate was doubled from 4 per cent to 8 per cent. Moreover, on this day the crisis, which had hitherto been a City crisis, threatened to become general. There was a large demand by the public for gold at the joint stock banks and the Bank of England. Currency quickly showed signs of becoming scarce,

more through apprehension than through any real want. It appeared as if the suspension of the Bank Act, by means of which an indefinite increase in the issue of bank-notes would be possible, might become inevitable.

On August 1, the political situation became hopeless; the Bank rate was raised from 8 per cent to 10 per cent, and even at this rate, representing an extremely heavy loss to all discounters, an enormous business in loans and discounts was done at the Bank of England. A large amount of gold was again withdrawn. The rates of all the great State banks on the Continent were raised. A general moratorium was declared in France, postponing the necessity for the payments of debts of every kind, and with the most drastic provisions for limiting the demands of depositors on their deposits.

III

N.B.

At the close therefore of this day, August 1, before a single shot had been fired, and before any destruction of wealth, the whole world-fabric of credit had dissolved. The Stock Exchange was closed; the discount market dead; the accepting houses unable to obtain any remittances as cover for bills falling due; the liquid assets of the joint stock banks, i.e., their Stock Exchange and Money Market loans, and their very large holdings of bills immobilized at the moment when their depositors were becoming restive; commerce at a standstill throughout the world; currency scarce; the Bank of England's resources highly strained. Such was the effect of a universal destruction of confidence. The position was one which needed immediate and drastic measures. It was impossible to say whether another day or two of such unrelieved tension might not produce very serious failures, a contingency it was necessary to avoid at all costs.

Fortunately the next day was a Sunday, and the day after that a Bank Holiday, which it was wisely decided to extend for three more days. This gave nearly a clear week for consultation between the Government and the City as to the measures to be taken to overcome the crisis and start the machinery again at work. The first measures essential in order to avoid

still greater trouble were to provide a supply of currency ample for all the demands of depositors, in order to calm the public fears, and forestall the hoarding of gold, and to deal with the situation which had arisen owing to the collapse of credit and the impossibility of obtaining remittances from abroad. To meet the first difficulty the Government agreed to provide the banks with an ample supply of £1 and 10*s*. notes, to the extent of 20 per cent of their deposits, i.e., up to a maximum of about £200,000,000, charging them 5 per cent interest. These notes are legal tender; they have at the back of them the whole credit of the British nation, and, presumably they are convertible into gold at the Bank of England. But they are not Bank of England notes, and it is to be supposed they will be withdrawn and replaced by bank-notes when the war is over. To meet the second difficulty the Government declared a moratorium, or postponement of debts for one month, applicable at first to bills of exchange, and two days later made more general to cover all payments and contracts with certain specified exceptions. All those, therefore, who found themselves unable to redeem their obligations through the general suspension of credit, were given a breathing space, and all bills of exchange in the discount market accepted previous to August 4 were renewed for one month. The suspension of the Bank Act, which would enable the Bank of England to issue freely bank-notes without an equivalent sum in gold at their back, was not actually proclaimed. It was decided instead to issue new currency notes, as stated above, which are not Bank of England notes but a direct obligation of the Government. Since, however, these notes are presumably convertible into gold, and since the only gold from which they can be met is the reserve of the Bank of England, the transaction is in essence equivalent to a suspension of the Bank Act.

The Bank return of August 5 showed that the Bank had lost a good deal of gold and its reserve in proportion to liabilities had fallen from 40 per cent to 14 per cent. Since that date the situation has improved, and on August 26 the Bank held nearly £16,000,000 more gold than on August 5, the result largely of fresh importations, but partly also of gold coming

back from the country. In fact the amount held was actually higher than at this time last year. So long, therefore, as the public show ordinary calmness, there should be no danger to the gold reserve. Unlike most other countries England has not yet found it necessary to suspend specie payments. There is no reason, if things go well, why she should. The export of gold is not prohibited, though no doubt if the Bank found that there was any likelihood of large sums being exported, by which its position would be weakened, it would take precautionary measures.

It was found on Friday, August 7, when the City resumed business, that these measures, aided by the liberal facilities freely granted by the Bank of England, were sufficient to calm public apprehensions. There was no run on the banks; there was currency in the plenty, and the moratorium safe-guarded, anyhow temporarily, the position of every one. The discount market was eased for the time being by being able to make loans or discounts at the Bank of England; the accepting houses were relieved from the immediate necessity of meeting all bills falling due, and the banks had been granted ample facilities by the Government in the way of currency. It was clear, however, that, while the moratorium had acted like a dose of morphia and deadened the City's agitation, some further measures were needed to galvanize it into any kind of life. The dead-weight of the enormous mass of bills, which ten days before had been looked on as gilt-edged security, hung like a millstone round the City's neck. Under the moratorium the joint stock banks were not getting their holdings of bills liquidated and, since those they already held were not being paid, they would buy no fresh ones; the discount houses could not work; they had very heavy liabilities in respect of the bills they held and of their endorsement on all bills they had sold to the banks, or to the Bank of England, and they were not willing to add to them by any more purchases; the acceptance business had come practically to a dead stop. Yet, if the whole bill-machinery of London were to stop, British trade, to say nothing of that of other countries, could not be financed. Grain was piling up in New York. Commerce was at a standstill. It was absolutely essential to resuscitate this

international currency in order to finance England's exports and imports and to enable America, the Dominions and the East to resume dealings with this country.

In order to relieve the situation, the Government took a drastic step. It authorized the Bank of England to announce that the Bank would discount under the guarantee of the Government all bills of exchange of satisfactory quality accepted before August 4, the holders of the bills being relieved of liability. In other words, any institution, bank, or discount house which held any bills accepted before August 4, could sell them at once to the Bank of England and be free of all further liability on them. The British Government guaranteed at one stroke to the holders all the bills in the market amounting, if the usual estimates are correct, to over £300,000,000. The relief to the discount houses and the banks was enormous. On the other hand, the liability of the accepting houses remains as before. This step was intended to enable the banks and the discount market to resume transactions at any rate in mercantile bills of exchange, drawn against actual produce shipped to this country and to enable them to meet all legitimate requirements of the country by providing them with large credit balances at the Bank of England. It is for them now to live up to their part of the bargain. It is impossible to say what is the real extent of the liability the Government has assumed. That depends largely on the extent and the result of the war. The vast proportion of bills will eventually be met. But that some debtors on the Continent will be unable to meet their engagements it is hardly possible to doubt. The Bank of England has further undertaken, when the moratorium ends, not to press for the immediate payment of all pre-moratorium bills as they fall due, but to continue to discount them indefinitely until further notice at 2 per cent above Bank rate. This is a heavy charge, but the arrangement gives the accepting houses time to liquidate gradually their obligations as their debtors redeem their liabilities.

The terms of the Government's guarantee of the bills now in the market were not clear in all their details and many important and difficult questions had to be settled from day to day as they arose. The question, for instance, whether only

the holder of a bill would be relieved of all liability or whether logically all English endorsers would not be released was a matter of great importance to the discount market. It appears now to have been settled by the further measures of the Government referred to below. But the enormous value of the privilege granted by the Government is seen by the fact that the Bank of England was regularly besieged every morning for some days by those who wished to discount their bills. Nor is this surprising in view of the prodigious mass of bills to be dealt with. The "other deposits" of the Bank of England, which only a month ago totalled only £42,000,000, had by September 2 reached nearly £134,000,000, a wholly unprecedented figure. There seems no reason why they should not go to £200,000,000 and over. This figure is the measure of the assistance which the central Bank has given to the City and also of the floating supplies of money and credit now in the market. The bills which the banks held were, as has already been explained, "frozen" during the crisis. By the action of Government and by the thawing influence of British credit, they can now be liquidated by the simple process of taking them to the bank and discounting them. The bank so doing receives a corresponding credit in the bank's books, which it can utilize in any way it likes. It is clear, therefore, that there are now large floating supplies of bank credits—and that there will be more—which should enable the banking community to deal with every legitimate demand for financial aid.

Furthermore, these supplies of money will be invaluable for the large loans which the Government must make. It is difficult at present to utilize large sums of money profitably, and Treasury bills afford an admirable means of so doing. One can observe, therefore, the curious process by which the Government lends its credit to unlock the wealth belonging to the banks, which the crisis has tied up, and the banks lend back that wealth, when it has been liquidated, to the Government.* Such is the subtle, yet all-powerful effect of that credit, which not even this great war has shaken, the credit of the British Government.

* This of course was the commencement of the process of "inflation."

Recently the Government have taken another important step, 4 designed to relieve still further the money market. The holders of bills having been relieved of liability, the Bank of England now undertakes to provide the acceptors with funds necessary to pay all bills accepted before August 4, by this means releasing all drawers and endorsers of their liabilities as parties to the bills. The acceptors must, of course, repay the Bank the amounts so advanced as soon as possible, but repayment will not be claimed until a year after the close of the war, and till then the Bank's claim will rank after all transactions subsequent to the moratorium. The Bank will charge interest at 2 per cent above Bank rate. Furthermore, it is stated that the joint stock banks, with the co-operation, if necessary, of the Government and the Bank of England, 5 will, under certain conditions, provide their clients with amounts necessary to pay their acceptances at maturity, where the funds have not been provided by the acceptors' clients. The upshot of the above provisions is that the capital of the accepting houses remains intact for the purposes of new business until the end of the period specified by the Bank and until therefore the foreign clients of those houses have had an opportunity of meeting their liabilities. Owing to this fact new business will certainly be stimulated. Discount houses and banks will have no hesitation in buying new bills and so facilitating trade, while on the other hand the accepting houses whose liabilities are merely postponed and not annulled will only enter upon fresh business of a most legitimate kind. It is certain, therefore, that the demand for new bills will be greater than the supply, and in consequence discount rates are likely to fall to a very low figure.

While these measures of the Government are satisfactory, it may perhaps be suggested that the Chancellor would do well not to hurry matters too much or to think that everything can be mended at once by granting facilities all round to every one. There is a great deal of wreckage which can only be gradually removed. The healing process of time is as essential to the recovery of financial health as the employment of patent medicines, effective though these latter may be.

It is unnecessary to enlarge upon the vital influence of the Bank of England aided by the Government, during this crisis. That influence has been evident during every financial crisis. A strong central bank is the very pivot of our whole financial system. Without such a reservoir of credit, available when every usual source is completely dry, our banking and discount system would be impossible.

Another problem had to be dealt with, which seriously concerned the Money Market. It was pointed out in a previous article that a war between England and Germany might necessitate the closing of the London Agencies of the German banks. This is what happened. The three great German banks, the Deutsche Bank, the Disconto Gesellschaft and the Dresdner Bank have for many years found it necessary to keep branches in London, as the world's financial centre. They do an active business, especially in financing German trade and accept largely bills of exchange, which are then discounted in the discount market. It is estimated that their liabilities on bills of exchange amount to between £15,000,000 and £20,000,000. As soon as war broke out, it became high treason for English firms to do business with them. Their offices were closed and it seemed doubtful whether they would be reopened. Ultimately the Government consented to their being reopened under the supervision of English accountants. They were not to undertake new business, but were to confine their activities to liquidating their assets in this country for the benefit of their English creditors. This was a wise and indeed an essential step. The £15,000,000 to £20,000,000 of bills were held in London; if the banks were closed and could not do anything to meet their obligations, it was the English holders of bills who were hurt and not the German banks, who had already had their money. As it is, the banks' assets in London, such as they are, can be at least utilized to pay off their English creditors as far as possible, leaving the balance to be settled after the war.

A further measure which the Bank of England has taken in order to do something to remedy the abnormal condition of the Foreign Exchanges which still prevents any proper resumption of international trade, is to arrange for the purchase

of gold deposited in Canada and South Africa with the Governments of those countries to its order. It will then grant facilities in London against this gold. This measure will be invaluable to the South African gold mines. It was hoped also that New York in particular would avail itself of this arrangement, but at present the financial community there shows the greatest reluctance to send any gold away even so far as Ottawa. One of the greatest difficulties in the resumption of business at the moment is the abnormal condition of the New York Exchange. The United States owe large sums to London which they can only pay either by shipping produce or by sending gold either to London or Ottawa. They appear to be holding back produce and they refuse to ship gold, action which is not far removed from refusing to pay their debts, in fact to declaring a moratorium. Meanwhile trade between the two countries is very largely at a standstill.

Notwithstanding the above measures, supplemented by the Government's further action in undertaking 80 per cent of the war risk in marine insurance, the City is still very far from normal. It is like a man whose nervous system has been shattered by a great shock. Tonics and stimulants may save him from complete collapse, but real recovery is a matter of months and even years. The industrial and commercial worlds are still completely dislocated and the financial world cannot therefore be otherwise. There is no confidence anywhere. All that can be expected is a gradual and slow recovery. If reasonable success crowns our arms, that should be a matter of certainty. The British banking system is the soundest in the world and there can be no sort of danger of a collapse, provided that the public continue to show the same admirable prudence and calmness that it has shown hitherto. What is required of every one, not only the public, but the banks also, is that they should continue to act as normally as possible. The public should refuse absolutely to hoard money or make any exceptional demands on their banks; the banks, on the other hand, should freely comply with all reasonable requests. Even the suspicion of an opposite course is the most certain way towards breeding an apprehension, which is the more dangerous the more unreasonable it is. The joint stock banks have

received unconditionally the most generous and lavish aid from the Government; but that aid was not given them to enable them to emerge from the crisis without loss. It was given them for the sole purpose that they might be fit to aid in every way possible the country's trade and finance. Owing to the Government's measures they have accumulated and will accumulate huge credits at the Bank of England and this money they must be ready to lend for all legitimate purposes. It has been stated publicly by the Chancellor of the Exchequer that while in most cases their conduct has been very reasonable, in some cases they have shown reluctance to fulfil this national duty, and he has intimated that still other measures may be necessary. The trade of the country must be carried on. The banks should discount freely commercial bills, which have been drawn to finance it. Bills against produce imported into this or other allied or neutral countries are a perfectly good security, and it is the obvious duty of the banks to discount them and to aid the discount market in carrying on its legitimate functions. To do otherwise would be to injure the Government and the country. Since, too, the Stock Exchange is closed, there must be many cases where individuals and firms must be able to borrow against securities which they cannot realize. These cases, too, the banks should treat with as much liberality as possible.

The general moratorium has lately been extended for another month. The question of its continued extension is a difficult one. A limited moratorium there must be and it must continue for a long time, in order to cover bills of exchange and Stock Exchange loans at any rate. But a general moratorium is undoubtedly hampering to trade and probably particularly so to the small man. It is possible that, if its sphere were limited, some relief might be found by the creation of a Government lending department, after the German manner, whereby loans have been made on all sorts of securities, whether personal or otherwise, in the form of special paper, which has the same status as bank-notes. This again would be simply another means of using the Government's credit to liquidate wealth now locked up.

The question whether the Stock Exchange should or can

be reopened is still more difficult. It is hardly conceivable that at such a time as this there can yet be buyers of stocks. If there are no buyers and only sellers—and sellers from other countries as well—prices would continue to fall with disastrous results. The position of the banks with regard to their Stock Exchange loans would become still more difficult, and there would undoubtedly be many failures on the Stock Exchange. Indeed, the process described earlier in this article would merely be resumed. Moreover, none of those brokers who have dealings abroad would be able to collect their differences from their foreign clients or obtain any remittances from abroad. Any real opening of the Stock Exchange therefore seems out of the question for the time being.

There have indeed been various schemes by which the Government's aid is to be invoked here also, but unfortunately Stock Exchange securities as a whole are of a different character from bills of exchange and it would be a very different matter to guarantee all Stock Exchange loans.

In any case it would seem but common prudence to wait for the first decisive results of the war, both by sea and land. If the Stock Exchange were open, and a really serious reverse were to be experienced, the results can be left to the imagination. Later, it may be possible to begin dealing in certain leading stocks for cash and it may in any case be necessary to open the Stock Exchange solely for the purpose of dealing in the new war loans.

Meanwhile it remains for the public and the financial world as well to remain calm, to carry on their businesses as actively as circumstances permit, and above all to refrain from any steps likely to lead to anything in the shape of a panic. The situation is not normal. It could hardly be expected to be. The Bank of England, backed by the Government, has enormously increased its liabilities and therefore increased the power of the other banks and the public to draw on its gold reserves. But, so long as every one is satisfied as to the soundness of the British Government's credit, there will be no danger of the reserve being unduly depleted. Gold is not wanted as currency. There are plenty of bank-notes and Treasury notes

for that purpose. It could only be wanted for hoarding, and any such action should be regarded as criminally unpatriotic. So long as the risk of capture at sea is not negligible, the rates of insurance are likely to be prohibitive for the export of gold. If all risk vanishes, then gold is just as likely to be imported as exported, since the power of attraction exerted by a high Bank rate would then tend to recover some of its normal strength.

What the ultimate consequences of the war will be it is difficult for the imagination to grasp. Much depends on its duration. Yet even now it has, through its universal effects on trade and industry, touched the lives of every inhabitant of every civilized country. There is no banker, no merchant, no trader, no shopkeeper in the civilized world whose business has not been affected. There are few civilized countries, in which a moratorium, or something equivalent to it, is not now in force. In the continental countries of Europe actually at war industry is, to a large extent, at a standstill. The result on these great industrial nations cannot but be tremendous. Germany's oversea trade amounts now to £1,029,000,000 per annum, France's to £615,000,000, Belgium's to £326,000,000, Russia's to £275,000,000, Austria-Hungary's to £256,000,000, and the internal trade of every country is greater than its external.

If we estimate roughly that 14,000,000 men are under arms, that one man can produce £100 of wealth in a year, we have at once a direct loss of £1,400,000,000, apart altogether from any indirect loss due to the dislocation of trade and finance and the enormous number of men thrown out of work indirectly by the war.

Let no country suppose that it is going to escape the effects of this great cataclysm. The United States, it is true, may capture a great deal of trade formerly done by continental Europe. England may do the same, and, to the extent that she can do so, it will undoubtedly reduce the evil consequences upon her of the war. But no country grows rich on the poverty of other nations. It is possible that after the war there will be a short period of great activity in making good the actual necessities of industry and of civilized life. But the purchasing

power of the world will have been very sensibly diminished, and it cannot be long before the enormous loss of capital will make itself felt. There is then likely to be a prolonged period of very great depression.

There is only one way by which the wealth of the world will be quickly replaced after the war and that is by work. It will be absolutely necessary that the productive capacity of the individual should increase very much compared to his capacity during the last ten years, during which it has undoubtedly been on the decline. The country whose workers show the greatest capacity for productiveness will be the country which will most rapidly recuperate.

Even now all countries, especially new countries, will have to change their mode of living. Take Canada as an example. Canada's annual balance of trade is probably about £60,000,000 against her: £30,000,000 being the excess of her trade imports over her trade exports and the remaining £30,000,000 representing her annual payment on money borrowed. She has balanced her account hitherto by borrowing very large sums of money. Now she will be unable to do that any longer. Nor will she at present, at any rate, obtain the immigrants on which she is counting to enable her to pay her interest. She cannot redeem the balance due by the export of gold. The burden would be too great in any case, and moreover she has suspended specie payments. A part of the balance due may be covered by the higher value of her exports, such as wheat. The remainder she can only meet either by increasing her exports or by reducing her imports. The latter she has already begun to do. Obviously, therefore, Canada and other new countries in the same position must re-adjust themselves to the new conditions. Until the effects of the war have passed and capital is again abundant, their progress cannot but be slower than of late years.

In the last article it was urged that any nation which thinks that by determining to take no part in war it will be unaffected by its consequences was living in a fool's paradise, that the certainty of enormous material losses would never stop war, and that when the issues involved were vital to Great Britain, the cost would weigh light in the balance; it was pointed out further

that London's central position in the financial world and the wonderful delicacy of her credit machinery laid it open in a great crisis to a sudden and intense strain, which might be relieved by financial measures and would certainly be relaxed by the success of our arms, but would be rendered almost certainly unbearable by our defeat at sea. The moral was drawn that the best protector of London's financial stability, and with it the financial stability of every part of the British Empire, was the British fleet. Argument is no longer needed to prove what is now self-evident.

DIARY OF EVENTS

July 28, 1914. For some days previous to this date there had been a heavy fall of securities on all Stock Exchanges and Bourses. The London and Berlin Stock Exchanges are demoralized. The Paris Stock Exchange is practically closed except for cash dealings. Brussels, Montreal and Toronto Stock Exchanges closed. Heavy liquidation of American securities from Europe in New York. All Foreign Exchanges demoralized. Rates only nominal. Great difficulty in making any remittances from one country to another. New York Exchange rate on London rapidly rising, due to heavy sales of securities from Europe. Commercial markets disorganized. Discount market in London disorganized. Heavy applications for loans and discounts to the Bank of England.

July 29. No dealings on the London Stock Exchange in morning. Seven firms default. St. Petersburg Stock Exchange closed. Berlin Stock Exchange, dealings only for cash. French Rente Settlement postponed. Continental Banks withdrawing foreign balances in London. Foreign Exchanges further demoralized. New York Exchange unprecedentedly high, far above gold point. French Exchange unprecedentedly low, far below gold point. Heavy gold shipments from New York to Europe. Over £1,000,000 of gold goes to Continent from London. Berlin Exchange very high. Bank of France ceases to pay out gold. 20-franc and 5-franc notes issued.

July 30. Bank of England rate increased from 3 per cent to 4 per cent. Bank of France rate from $3\frac{1}{2}$ per cent to $4\frac{1}{2}$ per cent. National Bank of Belgium from 4 per cent to 5 per cent. Bank of Sweden from $4\frac{1}{2}$ per cent to $5\frac{1}{2}$ per cent. London Stock Exchange practically ceases working. Paris Bourse settlement postponed and necessity of moratorium recognized. Vienna Stock Exchange

closed. Very heavy selling orders from Continent on London. Great fall in prices. Large withdrawals of money for Continent. All foreign exchanges nominal. All machinery for transmitting money from one country to another stopped. Gold at premium in Paris. Collapse on New York Stock Exchange. All produce markets demoralized. Bank of England return shows increase in loans and discounts of about £14,000,000 and the proportion of the reserve to liabilities falls 12 per cent. Further heavy discounting at the Bank. Discount market paralysed.

July 31. London Stock Exchange closed. Bank of England rate raised from 4 per cent to 8 per cent. Enormous demand for discounts and loans at 8 per cent to 10½ per cent. Large demand for gold at the Bank of England and the Joint Stock Banks. Currency becomes scarce. All financial machinery at a standstill. No foreign remittances possible. Practically all European Bourses closed. Reichsbank rate raised from 4 per cent to 5 per cent. Bank of Denmark from 5 per cent to 6 per cent. Austro-Hungarian Bank from 5 per cent to 6 per cent. New York Stock Exchange closed.

August 1. Bank of England rate raised from 8 per cent to 10 per cent. Bank of France rate from 4½ per cent to 6 per cent. German Reichsbank from 5 per cent to 6 per cent. Netherlands Bank from 4½ per cent to 6 per cent. Belgian and Danish rates from 6 per cent to 7 per cent. Enormous business in loans at the Bank of England. Moratorium declared in France. Complete and world-wide dislocation of credit. Large amount of gold withdrawn from Bank of England. Frankfurt and Johannesburg Stock Exchanges closed. Melbourne Stock Exchange closed except for cash dealings. For week ending August 1 New York ships over £5,000,000 gold to London and £2,000,000 to Paris.

August 2. Issue of Proclamation declaring moratorium in Bills of Exchange.

August 3. Bank Holiday. Bill for general moratorium passes Parliament. Bank Holiday extended for three further days.

August 7. City resumes business. Issue of £1 Treasury notes. Issue of 10*s*. notes being prepared. Proclamation of general moratorium. Large assistance on this and the following days given to the discount market by the Bank of England. Bank of England return shows a fall of the reserve in proportion to liabilities from 40 per cent to 14·6 per cent.

August 12. Government guarantees the Bank of England against any loss it may incur in discounting all bills accepted before August 4.

August 13. Bank of England return shows an increase in private deposits of nearly £30,000,000, and more than £40,000,000 over the return three weeks before. The proportion of the reserve to liabilities rises to 17 per cent.

By this time a more or less extended moratorium was in force in the following countries among others: France, Denmark, Norway, Bulgaria, Argentine, Brazil, Russia, Egypt, Cyprus, Italy, Sweden. In Brazil and the Argentine all banks were closed for a long period. In Canada, power to declare a moratorium has been taken by the Government. In all the great European countries, with the exception of England, and in others such as Canada, specie payments were suspended. In every country in the world with a developed banking system, a crisis of greater or less severity occurred and stringent measures of one kind or another had to be taken to deal with it.

III

WAR AND FINANCIAL EXHAUSTION

(December, 1914)

Much is said in the public press about the financial aspect of the war and the part which financial exhaustion is to play in bringing it to an end. But beyond the very general expression of beliefs, anticipations and hopes little attempt has been made to investigate how this financial exhaustion is to exert its decisive influence or what is the relative financial strength of the several combatants engaged. This is partly because no exact test or comparison or financial resources is feasible. But it is partly due also to a very dim apprehension as to what the wealth of a nation really consists in and as to the means which a nation possesses, even when it is hard pressed, of continuing a war. While, however, statistical comparisons between different nations may arrive at nothing like actual accuracy and are often even fallacious, and while this article does not pretend to treat the questions discussed from a statistical standpoint, it is at least possible to discuss the general elements of the problem, using such figures as are available mainly as illustrations of the argument. When figures of such magnitude are in question, comparatively large errors in calculation become of small moment. They do not invalidate the conclusions to which the figures point.

It is a matter of great importance that the British people should not sit down under the comforting idea that their opponents are likely to be forced very quickly to make peace by financial exhaustion. All history goes to show that actual want of money or financial distress has seldom brought a war to an end. Nothing could have been more wretched than the financial affairs of France at the beginning of the Revolutionary period. But they did not stop her from conquering

Europe. The Balkan States, small, poor and financially weak, conducted, without difficulty, two violent campaigns lasting over many months, and now Serbia is fighting a third war against a far more powerful opponent. The Boers, even after the whole framework of their States was shattered, continued the struggle for two years. Mexico has supported, during three years of chaos and rebellion, the armies both of her Government and her revolutionaries. So long as a Government has a printing-press, it can always make "money." If an army can find food, clothing, and munitions of war, it can continue to fight, so long as it wants to. If the people behind it can also produce not only food, clothing and munitions for its army, but food and clothing for itself, and if, in the case of a great modern industrial State, its vital newer centres of industry are not invaded and held by the enemy, it can continue to exist and to carry on the struggle, so long as it wants to. Given fulfilment of these elementary conditions, the problem is mainly a psychological one. If it cannot find the absolute necessities of life and warfare, either by producing them or buying them, a nation must no doubt stop; if it can find them, it can go on, at the cost, no doubt, of much suffering and sacrifice, so long as its population ardently desires and expects victory and the attainment of some great national object or ideal and regards all its sufferings and sacrifices as the price which must willingly be paid.

A review of the financial position of a nation may show that war will bring dislocation of trade, unemployment, high prices and great suffering, but it need not be assumed that all this is equivalent to exhaustion, or must drive it to peace. Before you can judge of its effects, you must know the temper of the people. This psychological element is by far the most important of all, and all conclusions deduced from purely financial considerations are subordinate to it. If is often ignored, and it has therefore been insisted upon as a preliminary to any discussion of the financial problem.

I. Cost of the War

The present cost of the war can only be guessed at. It has been stated—neutral, but mobilized States, being counted

as well as actual belligerents—that altogether there are not much less than 20,000,000 men under arms. If every soldier costs about 10*s.* a day the total cost would mount up to £10,000,000 a day. That is probably not far from the truth. The British Government, with not far short of 2,000,000 men now under arms, is stated officially to be actually disbursing about £1,000,000 a day, and its real expenditure is probably a good deal higher and will continue to grow. The official returns show an increased expenditure for the twelve weeks from August 8 to November 1 this year, as compared with the same period last year, of nearly £78,000,000. It has been stated in Berlin that Germany's daily expenditure is not much over £1,000,000 a day, but in reality it must be much greater, and is probably nearer £2,000,000; Russia is probably spending something like the same amount, France between £1,500,000 and £2,000,000, and Austria about the same. To this we have to add the expenditure of Serbia, Japan, Turkey and Belgium, and of all the neutral, but mobilized, States. If everything is taken into account, the total expenditure cannot well be less than £10,000,000 a day.

If these figures are more or less correct, it may be estimated that the cost of a year's war will be nearer £4,000,000,000 than £3,000,000,000. Whatever the figure, and even if the war does not last so long as a year, the cost will be gigantic. To estimate the significance of this great expenditure, it is necessary to get some idea as to the wealth of the nations which will have to foot the bill, and how that wealth is created.

II. English and German Wealth Compared

A nation's wealth is not the "money" it has or its gold or its silver stores. Its wealth is the total of the things, useful and therefore valuable to mankind, which its citizens at any one moment possess in their own or other countries as the heritage of the labour and services of past generations, or as the result of the labour—the continuing labour—of the present. In other words, a nation's wealth is of two kinds, first, its capital, or its fixed plant, that is, everything that former generations, as well as this generation in past years, have

laboured to produce ; cultivated land, houses, roads, railways, factories and so forth : and, second—and a very important part—the annual wealth produced year by year by the labour of its inhabitants. The bulk of that wealth so produced each year is of course consumed in feeding and maintaining the people and in keeping up to standard its fixed plant, its roads, factories, houses, and the like. The balance, if any, represents the surplus wealth produced, which may be utilized to improve the fixed plant of a country, or be lent to or invested in other countries.

It is, of course, a very difficult matter to ascertain accurately what is the wealth of a great nation, and any figures must be more or less approximate. Many calculations have been made, some differing widely from others. Some of the latest, probably accurate enough for Germany, are those given by Dr. Helfferich, one of the leading Directors of the Deutsche Bank, who was recently reported to be in Brussels engaged on behalf of the German Government in arranging German finances in Belgium. Dr. Helfferich has made a detailed study of the wealth of Germany and in the course of it institutes a comparison between the total capital wealth of Germany and that of her chief competitors. His figures are as follows :

	Total Wealth. Millions £	Wealth per head of population. £ £
Germany	14,200 to 15,600	221 to 240
France	11,400	290
England	11,300 to 12,700	250 to 284
U.S.A.	24,500	270

It will be seen that he estimates that the United States are the richest nation, Germany second, England third, and France fourth. On the other hand, other estimates have put the wealth of Great Britain a good deal higher, e.g., at about £17,000,000,000. These latter may be more correct, but at the same time it would not be very surprising, on *a priori* grounds, if Dr. Helfferich's order were correct. It follows not only the actual size of the different countries, but the numbers of their population. It would not be unlikely that the capital wealth, representing the land, houses, etc., of a country like

Germany of 208,780 square miles, with a population of upwards of 68,000,000, should be greater than that of a country like the United Kingdom of 121,391 square miles, with a population of about 45,500,000.

Still more important perhaps than the capital wealth of a country is its annual production. Here again figures exist relating to the two countries with which this article is principally concerned, namely, England and Germany, but they relate to different years. The English figures are those given by the Royal Commission on the Census of Production for the year 1907, published in 1912; the figures for Germany are those given by Dr. Helfferich for the year 1913. Their striking similarity is remarkable. The Royal Commission's figures are as follows:

	Millions £.
Goods consumed or exchanged for services by classes engaged in production and distribution	1,248 to 1,408
Goods consumed or exchanged for services by classes engaged in supplying services (i.e., Government servants, professional classes, etc.)	350 to 400
Additions by all classes to savings and investments	320 to 350
Total Income	1,918 to 2,158

Dr. Helfferich's figures for Germany are as follows:

	Millions £.
Total Income	1,960
For Public Purposes	343
For private use	1,225
Surplus wealth	392 to 417

Fifteen years ago the surplus wealth per annum produced by Germany was only from £220,000,000 to £245,000,000.

It will be seen that, while British savings in 1907 were estimated at about £350,000,000, German savings in 1913 were estimated at over £400,000,000. Since 1907 the wealth of the world has very largely increased and the wealth of England with it. It is probable, therefore, that the annual British savings are still well ahead of the German, notwithstanding the much smaller population.

Much of the savings of a nation are of course invested in

the development of its own country in one form or another. One man may decide to spend his new wealth on the creation of a pleasure house; another man on an addition to his works. The surplus not required in the home country is invested abroad. The difference between England and Germany is that, while probably between one-half and one-third England's surplus wealth is annually invested abroad, a much larger proportion of Germany's goes to develop that country itself.

It is important to note how large a proportion the annual wealth produced by a country bears to its total wealth. England's whole capital wealth is estimated at from £13,000,000,000 up to £17,000,000,000. She produces probably at least £2,300,000,000 now, or from about one-sixth to one-seventh of the whole every year, of which she adds now to her capital wealth probably something between £400,000,000 and £500,000,000. This fact explains the rapid recuperation which a country, able to produce wealth at a great rate, often makes after a war.

The figures given above enable one to see with some clearness what happens during the course of a great war. There is obviously a very great reduction in wealth produced and wealth saved. In the first place, if a country has, say, 4,000,000 men under arms, the productive capacity of these men is entirely lost. If one were to assume that each man produces about £100 worth of wealth a year, there would at once be a loss of £400,000,000 a year. The loss from this particular cause would in reality be much less than that, since not nearly every soldier is an active producer. Moreover, those left behind would work harder than ever and the empty places would be to some extent filled by women. None the less, the loss would be very large. In the second place, there is a great reduction in the output of wealth owing to the dislocation of trade and finance throughout the world. The wheels of the machine revolve more slowly and some of them stop for a time altogether. A great creditor nation like England suffers particularly from all this, since its dividends from abroad fall off, and probably its shipping and banking commissions. The British trade figures for August and September are symptomatic of the trade dislocation. British exports in August fell by

nearly £20,000,000 or in comparison with the same month last year by 45·1 per cent, in September by £15,750,000 or 37·1 per cent, and in October by £18,020,000 or 38·6 per cent. British imports in August fell by £41,200,000 or 24·3 per cent, in September by £45,000,000 or 26·5 per cent, and in October by £20,170,000 or 28·1 per cent. Trade may gradually become more normal, but meanwhile it is greatly embarrassed and wealth production consequently much less.

Thirdly, there is a great creation of non-productive instead of productive wealth, of wealth which is produced only to be destroyed straight away. The energies of industry are devoted to making shells, ammunition, guns, clothing, transport, materials and munitions of war of all kinds, which are not useful for creating more wealth and will in a few months have all disappeared.

Lastly, there is in many countries—in Belgium, France, Galicia, Poland, and East Prussia—the actual destruction of existing wealth, involving many millions of pounds' worth of property. England has, fortunately for herself, not yet experienced this misfortune, except in so far as the *Emden* and the *Karlsruhe* have destroyed her ships and her merchandise.

The total result then is that the annual wealth produced by a country is much smaller and its consumption greater. The effect of this will more easily be seen if the figures on page 73 are examined again. England's total production of wealth in a normal year instead of being £2,000,000,000, as it was in 1907—it would now be larger—would in a year of war be undoubtedly a good deal less. Not only would it be less in amount, but it would be different in character. An enormously greater proportion would be for consumption by classes engaged in supplying services—in this case soldiers and sailors. This figure instead of being £350,000,000 might be £650,000,000 or more. This would at once very largely diminish and probably wipe out altogether any savings, which the lesser production of wealth would in any case have enormously reduced. Against this must be set a reduction in the figure of £1,250,000,000 representing the ordinary consumption of the people, which would no doubt follow reduction in luxury, reduced expendi-

ture on maintaining the country's plant, retrenchment and savings among all classes. If all the other items of war expenditure, including aid given to friendly countries, claims for compensation for losses, insurance and the like, exceeded, as they no doubt would, the savings, then the country would be trenching on its capital and would have to make this good by additional production of wealth, after the war was over. In practice, of course, even if a country's expenditure in war were only to equal its savings, it could not raise the whole or anything like the whole amount in taxation. To increase taxation in England by £400,000,000 in one year, even if the nation's total savings were that, or even by half would be quite impossible. It is necessary to borrow in circumstances like the present for the larger portion of the expenditure, and for the Government to redeem the debt gradually by taxing in later years the surplus income of the population.

In a war of this magnitude, therefore, every country undoubtedly lives on its capital to some extent, and most countries to a great extent. All expenditure is reduced to a minimum ; the country's fixed plant runs down, just as a company, whose resources are taxed, ceases to maintain its depreciation fund. Generally speaking, the wealth of the country diminishes. Nevertheless, a country can live partly on its capital—just as a private person can—for a very long time. In fact, if the inhabitants of a country restrict their requirements to the essentials of life and existence, and if they can produce within their own borders enough food and munitions of war for themselves and their soldiers, and if they continue to believe in the credit of their Government sufficiently to take payment in paper money, there is nothing to prevent them from continuing the struggle indefinitely. It all depends on whether they want to. So long as a Government can issue paper money and persuade its people to take it, it can get along somehow. No doubt such a course may tend to depreciation of the currency, to rising prices, to the general dislocation of foreign trade, to such evils, in fact, that a civilized European community would and could suffer them for long only under the direst necessity and might be crippled by them for a long time afterwards. But it is as well to recognize that, if the sufferings of the non-combat-

ant population are not intolerable, if, in fact, the will to fight still prevails, and all hope of ultimate victory is not wholly extinguished, a country which is self-supporting can go on almost indefinitely, certainly as long as a European war such as the present is likely for other reasons to last.

If a country is not self-supporting and must buy from outside, the problem is different. The question, then, is whether the country in question can get in the necessary imports and, if it can, whether it can pay for them. If it cannot get them in, it may have to give up the struggle. If it can get them in, it must pay in goods or gold, unless it can obtain temporary credit in some foreign financial centre. It cannot pay with paper-money. A German bank-note is no good to an American merchant in New York. He must have dollars. If the country can pay for its imports with exports, its position is secure. If it cannot, it must pay in gold, and, if it loses its gold, the consequences to its financial life and credit may be serious.

III. England's Strength

The foregoing considerations make manifest the great importance to a country, if it is engaged in a long and exhausting war, of continuing, so far as possible, to produce wealth, and if it is not a self-contained country, of continuing to import and export it. So will it be enabled to keep up its national income and find the resources from which to carry on the struggle without exhaustion and with its credit unimpaired.

It is important to compare from this point of view the strength of the Allies on the one hand and their opponents on the other, and particularly the strength of England and Germany. Notwithstanding the comparative figures of total wealth already given, England is undoubtedly in one sense the richest country in the world. Her wealth is more mobile than any other country's; she earns it more easily, and she has the largest amount of surplus wealth at her free disposal. England has invested enormous supplies of capital all over the world, more even than France. Germany, though a borrowing nation herself, has also invested a great deal, but probably not more than a quarter of what England has. Germany therefore has to

produce nearly all her surplus wealth by actually working for it; England, on the other hand, is more in the position of a rich man whose balance at the bank accumulates comfortably by the payment of dividends on his investments. Probably nearly £200,000,000 are received in this way annually. England's great investments abroad are the result of her great trade over many decades. She developed her trade and began to accumulate wealth many years before most other countries, long before Germany in particular. She has been lending abroad for many years. Moreover, she has been able to lend her surplus income to other countries to a greater extent than Germany, because her increase of population every year is only 300,000, while Germany's is 900,000. While it is obviously a great national strength to have so large an increase in population as Germany has, it means that more capital is needed in Germany itself to provide the necessities of civilization and the means of livelihood for those 900,000 than England has to spend on 300,000. France, whose population is practically stationary, is a still greater contrast to Germany in this respect. While France's trade has never been so great as England's, she is a very rich country and accumulates great wealth through the saving qualities of the French people. Since, then, she has been accumulating capital for many years and since she has no increase of population, the amount she has available for employment abroad is proportionately greater than in the case of the more quickly developing countries. "France," Dr. Helfferich says, "is the land of capital; Germany is the land of work." Untrue as this is as an accurate description of the two countries, it truly depicts a tendency. England may be said to combine the qualities both of the capitalist and of the energetic producer of wealth.

There are some interesting differences in the lending activities of different countries which tend to show that national characteristics express themselves in finance as in other national activities. A Frenchman's love for the pleasant land of France and his disinclination to leave his country are proverbial. It may not be far-fetched to think that this is the reason why, in the main, France lends her money to Governments and is content with a comparatively small, but generally secure, return,

and prefers investments which unlike industrial investments do not require much looking after. In the main, France confines herself to European Governments and particularly to Russia and the Balkan States, but she lends also largely to the Governments of South America, Brazil, the Argentine and Mexico. But Frenchmen have also, in addition to their liking for safety, a distinct speculative turn. What they do not lend to a Government, they will probably put into gold or other mining enterprises in South Africa, Mexico or elsewhere. England is more catholic. While she lends, it is true, largely to Governments, though hardly ever to European Governments, she has used her money in general to develop every conceivable kind of industrial and other undertakings throughout the world. It is hardly too much to say that the railways of the whole American continent have in the first instance been financed by English capital. Englishmen have left their home-country in order to manage these undertakings all over the world. If a French banking group makes a loan to the Argentine Government, the matter is finished there and then, and all its security is on the good faith of that Government; if an English company puts money into an Argentine railway, it usually sends out Englishmen to look after it. It is noteworthy that though France, next to the United States, has put most money into undertakings in Mexico, there were many Englishmen, Germans and Americans there before the recent trouble, but few Frenchmen.

There are certain disadvantages as well as advantages in being the banker of the world. The great disadvantage—and it was seen clearly on the outbreak of war—is that in a crisis it is unpleasant to be owed very large sums from abroad, if you cannot get the money owing to you when it is due. And this is what happened in London. Hitherto the machinery by which one country can remit money to another has never broken down. But in the last days of July of this year something happened that has never happened before in the history of the world. There was an absolute breakdown in the financial machinery of the Foreign Exchanges, not only in Europe, but in New York and everywhere else throughout the world. However much debtors wanted to live up to their obligations,

they could not do so, for it was for the time being quite impossible to remit money from one country to another. Of course Germany and Austria-Hungary did not want to, and would not have paid in any case. But there were other countries like the United States, which owed us very large sums and could send nothing. The New York Exchange rose nominally to such extreme heights that any one remitting money from New York to London would have lost 40 per cent in doing so.

This complete financial breakdown was the main reason why a moratorium was necessary in this country. Those who could not get their money from abroad would not have been able to pay their debts and a first-class financial crisis would have ensued. Germany was in quite a different position. Being a far greater borrower, at any rate of short loan money, than she is a lender, she had merely not to pay her debts. To that extent the war was temporarily a positive advantage to her.

It may be worth remarking here that the stories of Germany having deliberately created a panic in London at the end of July by withdrawing huge sums are so much nonsense, as every one with a knowledge of the facts must have known. No doubt Germans with balances in London tried to withdraw them as did Frenchmen and every one else. But on the whole, as the Berlin Foreign Exchange showed, more money was being remitted from Germany to England at that moment than from England to Germany.

But against the disadvantages of being a great creditor nation, there are much greater advantages. The world has to pay England the money it owes her either in goods or gold. Ordinarily, of course, it pays in goods and only the fractional balance is settled in gold. The official returns show that last year England's imports of merchandise were £659,000,000 and her exports £525,000,000. But the figure for imports represents in part payment by other countries for what are often termed "invisible exports," not appearing in the figure for exports. These payments represent, for instance, interest on loans and investments abroad, perhaps £190,000,000, shipping commissions, perhaps £100,000,000, banking commissions, perhaps

£40,000,000. Out of the £659,000,000 worth of goods imported into this country, £330,000,000 may therefore be said to represent payments for interest and commissions. That would leave £329,000,000 of imports against exports of £525,000,000. The balance of about £190,000,000 of exports may be said very roughly to represent the surplus capital we lent abroad last year. Now, it is obvious that if, while ceasing to lend money abroad, as in great measure we no doubt shall, except to our Allies and to the British Dominions and Colonies, we maintained our exports and our imports unchanged, other countries would have to send us extra goods to the amount of £190,000,000, or to send us gold.

The problem of course does not in practice work out so simply. When England reduces her foreign investments, even when there is no war, exports invariably diminish also. Again, our dividends and commissions are certain to fall off to some extent. What will undoubtedly happen is that both our exports and imports will suffer a reduction and still more will change in character, especially our imports. It must be remembered, moreover, that the British Government will be bound to lend very large sums to the Dominions and to its Allies. It has, in fact, as the Prime Minister has stated, lent already or undertaken to lend £44,000,000. On the whole, however, it is likely that the balance will be in our favour and that, if we wish to, we shall be able to draw gold for our central bank reserve from the world. Certainly the tendency has been that way hitherto. On August 5 the Bank of England's gold reserve was £26,000,000; on November 4 it was just under £69,000,000, and in addition the Government has already created a reserve of £12,500,000 against its issue of Treasury notes.

It is also the fact of being so great a lender that has enabled London to remain the only really free market for gold in the world. Any one who can get bank-notes or has a credit with the Bank of England can obtain gold. But you cannot exchange a note either of the Imperial Bank of Germany or the Bank of France for gold. Even in New York, though Americans are accustomed to call it a free gold market, it was impossible recently to obtain gold for export in payment of debts due to England owing to a general determination on the part of the New

York banks to prevent it. In New York, too, specie payments are ordinarily suspended in every crisis. Now it is a matter of first-class importance that London should remain a free gold market. To that it will be due very largely that she will be able still to assert her claim to be the financial centre of the world. So long as that is so, all the banks and financial institutions of the world will look to London, since they know that, if they must have gold to pay their debts, they can always go to London and get it. It is also a matter of first-class importance that we should maintain and increase our stock of gold. That will enable us to maintain and increase our superstructure of credit and this will be of great importance for the issue of war loans, and in helping us to finance our friends and Allies. Moreover, as the war continues, we may be using more paper money. The issue of the £1 and 10*s*. Treasury notes amounts now to £30,000,000. It might later increase largely. It is therefore essential that we should keep the balance of trade in our favour and for this we must maintain our exports. The command of the sea is vital to our financial well-being.

Hitherto, it is interesting to note, the British Government has raised money on terms which compare favourably with other countries. The French Government is issuing temporary Bons de la Défense Nationale bearing interest at 5 per cent; the 5 per cent German Government loan was issued at 97½, and the Russian Government is issuing a 5 per cent loan at 94. Before the issue of the War Loan the British Government had borrowed £90,000,000 by means of Treasury Bills at an average rate of interest of £3 11*s*. 7*d*. It has now issued a War Loan yielding exactly 4 per cent, and redeemable in ten years' time for the stupendous sum of £350,000,000, far the biggest financial operation in the history of the world. The War Loan is an exceedingly attractive security. The Bank of England has undertaken for a period of three years to lend money without any margin against the War stock, taking the security at its issue price, i.e., 95, charging interest at 1 per cent below Bank tate. These exceptional facilities render an investment in the War Loan attractive and feasible for all classes of investors, the only possible risk being the chance of further loans being required, and of the security falling

temporarily below its issue price. The great success of the loan is, however, in any case a tribute to the enormous financial strength of the country. The credit of the British Government is still unsurpassed. So long as we retain command of the sea, it should remain so. If we lose it, our position, instead of being the best, becomes the worst.

IV. The Position in Germany

Germany, as the figures already quoted show, is financially a rich and powerful nation in a stage of rapid development. A hundred years ago Germany had a population of 21,000,000, France of 29,000,000, the United Kingdom of 17,000,000. To-day Germany's population is nearly 70,000,000 or about 50,000,000 more than 100 years ago; France 39,000,000 or 10,000,000 more, and the United Kingdom 45,000,000, or about 28,000,000 more. What will the figures be 100 years hence? Since 1871 Germany's population has increased by 26,000,000, while France's has increased by 3,000,000 only and England's by 14,000,000. Germany's wealth has been growing by leaps and bounds. It is probably growing as fast as ours and faster than France's. As in all other departments of life, so in finance she is thoroughly organized. She has a very strong and very well managed banking system, controlled by men of thoroughly expert knowledge. She had taken all steps long beforehand to mobilize her credit and her resources on the outbreak of war.

But she has two weaknesses as compared with England. Though a great creditor nation she is not nearly so great a creditor nation as England, and, while she is almost as big an importing nation, she does not command the sea. Last year Germany imported £526,000,000 of merchandise, of which more than half represents raw materials and about £150,000,000 represents food and animals, against her exports of £495,000,000. She has no doubt considerable investments abroad, but not nearly as large as those of England; they are estimated by Dr. Helfferich at £1,000,000,000, as against England's investments of not far short of £4,000,000,000. Moreover, she earns nothing like the same sum in shipping and banking commissions.

While England earns from all these sources probably about £330,000,000, Germany earns probably under £100,000,000. If, therefore, her exports are very largely cut off, she cannot pay for nearly so large a proportion of her imports by money due to her from abroad as England can. She must work for her imports, and in the main she must pay for them either in goods or in gold. As the figures above mentioned show, Germany is not much more self-contained than England, and it is therefore as important for her, as it is in the parallel case for England, that her trade should continue to be as normal as possible. But it is a great deal more difficult for her to achieve this end, and our whole efforts should be devoted to preventing her from doing so.

What is of the greatest importance is to throttle her imports. Not only would the complete cessation of such imports as petrol, rubber, copper, nickel and so forth be a serious hindrance to her creation of munitions and engines of war, but German industry in general relies very largely on the import of all sorts of other raw materials. Owing to the great changes in international maritime law made by the Declaration of Paris in 1857 England's power to destroy commerce is far weaker than it was in the Napoleonic era, and there are great and, indeed, insuperable obstacles to any attempt to ruin Germany's oversea trade. We have, too, to be careful to avoid serious trouble with neutral countries and in particular with the United States. Since we cannot touch non-contraband goods in neutral vessels, whether they are being imported to or exported from Germany through a neutral port, it is impossible to prevent an import and export trade being conducted through neutral countries like Holland, Sweden, Norway, Rumania, Italy and Switzerland, and it is certain that Germany is doing a very large trade in this way. There are lines of steamers from Genoa, Amsterdam, and other places which serve the purpose. If we could stop Germany's exports, her position would be very seriously damaged. It has already been pointed out that Germany can in the main pay for her imports only by her exports. If we were to throttle the latter, we should have gone a long way to throttle the former too. It is most unfortunate from this point of view that international obliga-

tions were ever assumed, which so completely tie our hands.

None the less, German industry must be suffering very seriously. The great development of German industries in the past few years has been based on the energetic extension of their world trade. They cannot exist solely on their home market. They must therefore be very hard hit in more than one way. In the first place Germany ordinarily exports annually to countries with whom she is now actually at war £160,000,000 worth of goods. All that is absolutely cut off. Moreover, her trade with neutral countries must be restricted, by extra railway charges owing to longer land carriage, by higher commissions, by difficulties in financing and by the great difficulty in many cases of obtaining the necessary raw materials. If we add to this the fact that she has mobilized so great a proportion of her male population, we need have no doubt that Germany's economic upset is far greater than ours, and that, as the war continues, she will suffer more than we shall from economic exhaustion, unemployment, and dearth of food and of raw materials—provided we always retain command of the sea. She must find more difficulty than we do in importing what she finds necessary, and in exporting enough to pay for those imports. The worst for her would be that she would cease to be able to import one or more commodities quite essential to her; the next worse would be that, while obtaining the imports she wanted, she could not pay for them except by the export of gold. The heavy fall in the German exchange in New York looks as if Germany had already been buying a great deal in America and was finding some difficulty in paying. The level of the exchange shows that Germany is being forced now to pay about 12 per cent more for imports than before the war. This in itself, unless the exchange becomes normal again, is bound to lead to a rise in prices in Germany. But it cannot yet be said that her currency is depreciated.

It is estimated officially in Germany that the last harvest fully covers her requirements so far as rye, oats and potatoes are concerned. With present supplies wheat, which appears to be much dearer in Germany than in England, will last till the beginning of September. Official steps have been taken to

economize wheat. In all wheat bread there must be 10 per cent of rye. Flour made from potatoes is to be mixed with all rye bread. Maximum prices, which are well above pre-war prices, are fixed, and it is hoped by these and other measures, and no doubt by importation through neutral countries, to escape any real shortage of food. The supply of fodder for cattle, which is imported largely from Russia, is a greater problem, and it is difficult to see how it will be solved. On the whole, however, it may be said that food questions will not become really serious for a good many months.

The outbreak of war found Germany absolutely prepared, in finance just as in everything else, with the measures which she thought necessary to meet the crisis. England, on the other hand, was equally unprepared. Nothing had been thought out; there were difficulties in the way of a thorough co-operation of all those whose co-operation was absolutely necessary, and to some extent it was a case of muddling through, luckily with no small measure of success. In some ways there seems to have been a greater financial crisis in Germany than in England. The public was more alarmed, and there were a good many runs on banks; whereas, notwithstanding certain provocations, the public in this country kept its head extraordinarily well. At the beginning of August the Reichsbank suspended specie payments, and issued a large number of fresh notes, which were thus inconvertible. Furthermore, there were at once created throughout the country Darlehenskassen, or Government Loan Agencies, which number now over 200, and which are authorized to make loans against securities of all kinds up to a total amount of £150,000,000, paying out as currency their own notes, which appear to be legal tender. It is difficult to ascertain exactly how many of these notes have now been issued, but the amount appears to be something under £50,000,000.

These Darlehenskassen no doubt perform a useful function in liquidating stocks of goods and commodities of all kinds and relieve the pressure on the Reichsbank. They were also especially intended to facilitate subscriptions to the War Loan. Any one who had securities but not ready money could raise a loan on his securities and invest it in the War Loan.

If pushed to any great length, this obviously becomes a dangerous operation. No doubt if Germany were successful and obtained heavy indemnities and if German Government stocks remained at their present level, no great difficulties need be anticipated. But if the contrary is the case, and German stocks depreciate in value, the unfortunate holders will find that to raise loans from the Darlehenskassen for investment in Government securities is simply another way of overspeculating and overtrading. The operation becomes still more risky to financial stability if, as seems clear, the notes of the Darlehenskassen, when paid in to the Reichsbank, are treated by them as available, together with gold, silver and treasury notes, as the basis for the issue of Reichsbank notes. Necessity knows no law, but it can never be anything but bad finance to issue paper based on paper. In any consideration of these special measures taken to facilitate the War Loan, the difficulties caused by the non-existence of the Stock Exchange and the complete absence of buyers, and the consequent inability of any one to turn his securities into cash by sale should be borne in mind. Unless a man has actual cash in his bank, or can obtain a loan against his securities, he is powerless in present circumstances to subscribe to any new issues, and this is a difficulty which, but for the special facilities offered by the Bank of England, would be felt here as well as in Germany.

By the issue of a large amount of notes, both of the Reichsbank and the Darlehenskassen, and of silver, by heavy discounting of bills, and by certain judicial measures, Germany was enabled to avoid a moratorium. Judges were given power to extend the time for a debtor unable to meet his liabilities, and Government officials were empowered to supervise the affairs of a business man, who was only temporarily embarrassed, without his having to be declared bankrupt. It appears that the extra amount of notes, metallic money, and Treasury notes issued amounted at the time of the War Loan to about £135,000,000.

Germany, as is well known, recently issued a War Loan by which she raised £220,000,000. That is a large financial operation, and there is no doubt that it was a great success. Even though various special facilities were given by the Reichsbank, by the Darlehenskassen and also by the Savings Banks, it was

undoubtedly evidence both of the wealth and the patriotism of the country. The terms of the loan were favourable, the return in interest being over 5 per cent. The number of subscribers was 1,150,000, out of whom 900,000 took £100 only or less, 200,000 taking only from £5 to £10. Special facilities were granted by the Savings Banks, and their depositors subscribed, it appears, for about £45,000,000. Krupps, it is interesting to note, subscribed for £1,500,000. Before many months Germany will have to raise another loan. If the campaign goes against her, or even does not go with her, the next large operation will of course not be nearly so easy. But it is worth while repeating that so long as the Government has a printing-press, it can make money and can pay its way with it, so long as the German people trust it, and wish it to continue the struggle. Similarly, difficulties of food supplies, of unemployment, and of high prices, while they will all increase, will probably not—taken by themselves—be sufficiently serious to compel peace. It will be their cumulative effect which will press hard upon the German people, unless they are counterbalanced by great victories in the field. It is possible that Germany may fail to obtain supplies of one or more absolutely essential imports. But it is not well to rely on this. In the financial and economic spheres the fundamental question is the psychology of the German nation and the measure of the sacrifices it is prepared to endure. There is everything to show that that measure will be a large one. Before her sacrifices become too heavy for her to bear, the campaign will probably be already decided, either by victory in the field for one side or the other or by the appalling slaughter and the physical exhaustion of her own or her opponent's armies.

V. France, Russia and Austria-Hungary

There is no space in which to consider at any length the conditions of France, Russia and Austria-Hungary. The same general considerations mentioned at the beginning of this article apply to all of them.

Austria-Hungary is undoubtedly the weakest financially. She is a borrowing nation in the best of times, and Germany

will no doubt have to assist her. But since her industrial life is not so highly organized as Germany's she will feel the shock to it less. She will have to live on paper money, and will suffer the various economic ills which follow in its train. Her capacity to continue depends on her power of producing, buying or borrowing the food, clothing and munitions of war she requires. She has plenty of food. Her greatest difficulty may be to provide herself with the necessary munitions of war. Imports are probably necessary for these and it is probable that Trieste will be closely blockaded, so that, if she must import them, she must import them through Germany. Her industries will suffer from the same ills as those of Germany.

France is a very strong financial power. The French people are the greatest saving people in the world. They have enormous investments abroad and, next to England, France has more capital to spare than any other nation. The French employ their savings very largely in foreign investments, while the Germans use theirs mainly to develop their own country and its industries. The French may make 5 per cent on their money ; while the Germans— though they may sometimes lose it all—will more often make 10 per cent and upwards. Thus Germany in all probability is growing richer more quickly than France.

Meanwhile, in this war, France has this great advantage over Germany that, even if her exports were to fall off altogether, the money due to her in the form of interest from abroad, which is estimated to be not much less than that due to England, would pay for a large amount of imports. She has also a great advantage over Germany in that the seas are absolutely open to her. Her exports and imports of merchandise in 1913 were respectively £275,000,000 and £340,000,000. Furthermore, wealth in France is very well distributed and it is a great strength to her that she has so many millions of small investors and capitalists.

Her disadvantages are that an important section of her country is invaded, which, as the Germans well realize, is most exhausting and distressing to her, and that her financial and economic life is greatly hampered by a very harsh moratorium. It so happened that for some time before the outbreak of war

the French banks and banking world—apart, of course, from the Bank of France—had been in a bad way. They had lent too much money, particularly to the Argentine, Mexico and Brazil, all of which countries were themselves embarrassed, and their resources in consequence were not nearly as elastic and liquid as they should have been. As a result the Government, in order to save the banking position, had to decree an extraordinarily harsh moratorium, much worse than anything known in England. The Banks unwisely almost stopped business altogether. No depositor could get more than 250 francs at a time, plus 5 per cent, out of any balance he had, unless he were an employer of labour, when he could draw out enough to pay his wages. Things are a little easier now, but few steps have yet been taken to straighten out the financial difficulties, and the present situation must be very hampering to French trade. Nevertheless, France has great internal strength and recuperative powers and should be able to last out financially as long as Germany.

Russia is the most self-contained of all the Great Powers at war. Her only weakness in this respect may be that she may urgently require munitions of war, which she may not be able easily to make herself. That would be a serious drawback to her, since now her only door open to the world is through Vladivostok or Port Arthur and right across Siberia. The Dardanelles are closed, and Archangel is ice-bound. Otherwise she can provide herself with all she can require. Her wealth has been increasing very quickly. She has a strong banking system. The economic effect of the war will be much less on her than on the far more highly developed industrial system of Germany. Her financial exhaustion is not likely in any case to be so serious as to compel her to discontinue the struggle.

VI. Conclusion

It is too early yet to discuss what will be the financial and economic results of the war. They must be great, and if it lasts long, they will be terrible. A year's war expenditure will not be far short of £4,000,000,000, and so huge a destruction of wealth as is taking place, so large a draft on the world's

capital cannot but react profoundly on its development during the years following. It is possible that immediately after the war there may be a short period of seeming prosperity, a small boom for a year or two while the absolute necessities of civilization are being replaced, but the lack of capital on the one hand and the greatly reduced purchasing power of the world's population on the other must soon tell, and there must inevitably be then a more or less prolonged period of stagnation and depression, while each country is building up its reserves of capital. The world after the war will be just like an engine whose fires have been allowed to die down. It will be necessary to build them up and heat the boilers up again, before there will be enough steam to enable the world to move again at the pace it has been doing in the last decade. On the other hand, the figures already given of the annual production of wealth show at what a pace wealth can now be created with the help of modern machinery and modern means of transport. The country which will recover the quickest after the war will be that one whose population devote themselves with the greatest energy to replacing what has been lost.

But what is more important at this stage is not what will happen after the war, but what will happen during it. If the war is a prolonged one, financial and still more economic considerations will exert greater and greater influence. But for some months to come their influence will not be decisive or even serious. The Allies, it is true, have in the aggregate much greater resources in wealth and population than have Germany, Austria-Hungary and Turkey. Germany, on the other hand, has the great advantage of concentration and absolute preparedness. Her whole aim is and must be to deal her foes rapid blows so violent and shattering in character that they will be forced to make peace, before any process of economic exhaustion has begun. In this it does not appear that she will succeed. But it may well be that the issue of the struggle will be decided in the next three or six months, and, if it is, it will have been decided not by any economic or financial considerations, but by the force of arms on sea and land. Therefore, though our task must be to weaken Germany economically and financially in every possible way, it would

be folly on our part to look to such influences to decide the war in our favour. Our business is to beat Germany in the field. If economic influences tell on our side, so much the better. But by themselves they will never enable us to impose a satisfactory peace on our enemies. Moreover, they will tell on our side upon one condition and one condition only.

The people of the British Empire have learnt much during the last three months and will learn more still, before the war is over, as to the true source of their strength. Command of sea, now as always, stands between the Empire and destruction. Command of sea is all that separates victory from disaster. So long as the British Navy commands the sea, the British Empire cannot be defeated. If it loses command of the sea, the Empire cannot win. All discussion of financial, economic or other war problems must finally come down to that simple elementary truth, and it would be well, were it burnt into the mind of every subject of the King throughout the world. This country has won her great struggles mainly by defeating her enemies' fleets and partly by the incidental method of destroying their commerce. After more than one hundred years her supremacy at sea is again challenged, and, altered in many respects as the problem is, its grand outlines are still the same. England has, it is true, in times of peace wisely or unwisely abandoned some weapons of sea power which she formerly wielded with effect. She cannot now, since the Declaration of Paris, touch non-contraband goods consigned to the country of her enemies, when carried in a neutral ship, nor can she do anything to interfere with enemy exports carried in neutral ships. "Moderation in war," as Lord Fisher says, "is an imbecility," and we may deplore now this diminution of our powers, since, so far as trade is concerned, it renders the power of our Navy more defensive than offensive. Yet it does not affect our sea supremacy. Nothing will affect that but the defeat of the fleet itself.

If such defeat were ever to come, then Great Britain and all her Dominions would lose everything: empire, possessions, shipping and commerce. Their Colonies would be taken, their coaling stations seized, their ships sunk and their commerce destroyed: All that would be an easy task for a victorious

fleet. Neither Conventions nor Declarations, neither Hague Tribunals nor Laws of Nations would prevent our foes from employing every weapon to their hand for our destruction.

Fortunately we have good faith that the British Fleet is more than equal to the task before it, and for this let us be thankful that we did not listen to those misguided doctrinaires, who with their incapacity to look facts in the face, to distinguish the real from the unreal, urged us in season and out of season to weaken our fleet, and fatally to reduce even that small margin of insurance on which not a few paltry millions but our whole life and nationhood depend. Let us also throughout the Empire mark and learn the lessons which this war will teach us. While every part of the Empire is equally and vitally concerned in the command of the sea, yet the very breath of the Empire's fleet is unity. If the Grand Fleet itself is defeated, small, weak, and distant squadrons must either uselessly keep their harbours or be sent to the bottom. The shores and commerce of all the Dominions as well as of the British Islands will then be open to the attack of the victorious enemy. The whole Empire is therefore equally concerned in the Navy's strength and it is vital to every part that in this and in every war there shall be present on the day of decision and at the decisive point an irresistible and united Fleet.

IV

FINANCE IN WAR

(JUNE, 1915)

In the previous article written six months ago an attempt was made to estimate the financial resources of the principal nations engaged in the present war. The purpose of this article is to follow the matter up, firstly, by analysing the manner in which a great war is paid for ; secondly, by examining shortly the financial methods which the combatant Governments are employing to mobilize the wealth of their respective nations for war expenditure ; thirdly, by discussing the probable effect of the war expenditure on the financial future of the nations engaged. Readers of the previous article will find in this one some repetition, which is made for the sake of clearness. A caution must be added with regard to the figures quoted in both articles, that in many cases they are only conjectures approximate to the truth, since there are no complete and exact statistics of the figures of national wealth or national income for any of the countries concerned.

I. HOW WARS ARE PAID FOR

A private person who incurs some extraordinary expense, such as that of a long illness or a costly lawsuit, will meet it in one of three ways, either out of his income, or out of his capital, or by borrowing. Similarly a nation which goes to war must meet the expense of the war from one or other of three sources. The first source is the current income of the nation. What this consists in will be discussed later on. The second source is the capital or accumulated wealth of the nation. The third source is a foreign loan. Let us call these three sources A, B and C.

To avoid misunderstanding, it should be pointed out here

that the income of a nation is something quite different from the income of its Government. The income of a Government is only a fraction of the national income, being that part which is taken by means of taxation to meet the expenses of the State. The balance of the national income remains in the hands of the people and is expended by them. Similarly the national capital is the accumulated wealth belonging to the people as well as that belonging to the Government. It is necessary to make this distinction clear, because the expense of a war may be met by a nation out of its income, though the Government may meet it by a loan: that is, if the people save enough during the war to pay for it, and the Government borrow their savings. Conversely, a Government might defray the expenses of a war by special taxation, refusing to raise a loan; while the people might pay the special taxes not out of their current income but out of their capital, their accumulated wealth. But this last is not likely to happen.

Having made this distinction, let us examine the three sources separately.

Source A. National Income—

The income of a nation may be defined roughly as consisting of:

(*a*) Its current output or production of wealth, in the form of usable or saleable articles of any kind.

(*b*) Its earnings from other nations for services rendered.

(*c*) Its revenue derived from foreign investments.

Thus the gross income of the British nation for the year 1913 consisted of:

(*a*) The total value of all the usable or saleable articles produced or manufactured in the country during 1913.

(*b*) The earnings of the country through payments made by other countries for services rendered—for example, payments by foreigners to British shipping companies for freight, payments by foreigners to London bankers by way of commission, etc., payments made by foreign tourists for various services and so on.

(*c*) The revenue drawn by residents in Great Britain from their foreign investments.

It will be noted that items *b* and *c*, that is the income derived from earnings and the income derived from interest on investments, are limited to the income of this sort which is derived from abroad. For, if the earnings or the interest are derived from a British source, they are already included in the first item, that is, in the country's output of usable or saleable articles, since it is out of this that they are paid.

For example, if a British shipping company receives from a British trader £10,000 for the freight of merchandise carried on his account, the freight is included in the final sale price of the merchandise when it leaves his hands. That is to say, it comes out of the final sale value of that part of the British output. If the value of the output has already been reckoned in the computation of the national income, the payment of freight is a transference and not an addition. But if the shipping company receives £10,000 from an American trader, for carrying his goods to Europe, or for carrying to America goods which he has bought in Great Britain, the payment of freight is an addition to the gross national income of Great Britain.

Again, if Mr. Jones of London owns shares or bonds in a British brewery company, the revenue which he draws from his investment is simply a part of the company's gross income and represents a part of its output during the year, that is, so many bottles of beer. As the company's total output has already been reckoned in computing the national income, the payment to Mr. Jones must not be reckoned again. But if he owns shares or bonds in the United States Steel Corporation, the revenue he derives therefrom is not a part of the British output of wealth, but of the American. It is therefore an item in the national income which has not been reckoned before, and must be added to it.

The gross income of a country as defined above will be reduced by any charges that there may be on it in the shape of interest due to other countries on money lent, or payments made to them for services rendered. When these deductions have been made, the net national income which is left will be used in the following ways:

(*a*) To meet the current living expenses of the nation, that is, to provide it with food and clothing and whatever

other articles of necessity or luxury it may consume in the course of the year.

(*b*) To maintain and improve what may be called the national plant and equipment, e.g., by keeping up and adding to its buildings, its machinery and so on, or by improving the land through drainage or clearing, or by constructing new roads and railways, or in many other ways which it is too long to enumerate.

(*c*) To invest abroad.

Now, in order to illustrate the payment of the expense of a war out of national income, let us take an imaginary case. A country called Utopia has 10,000,000 inhabitants. Its national income is £500,000,000 annually, of which £400,000,000 represents its annual output or production of usable and saleable articles; the remaining £100,000,000 it gets to the extent of £60,000,000 by way of interest on its foreign investments and to the extent of £40,000,000 by way of payments from other countries for services rendered. It spends its national income as follows: £350,000,000 for current living expenses, £100,000,000 on the maintenance and improvement of the national plant, the remaining £50,000,000 is each year invested abroad.

Utopia engages in a great war. The first point to examine is how this will affect the different items of its national income. The revenue from foreign investments will not be affected at all, unless part of it is drawn from the country with which Utopia is at war, or unless the war is so wide-spread as to impair the capacity of the debtor nations for paying interest on their debts. The earnings for services rendered to other countries may be affected either by Utopia becoming less able to render such services while the war lasts, or by the demand for them decreasing in war time. Lastly, the current output may and probably will be affected, even though Utopia is not invaded, by the drawing off of its population for military service and by the disorganization of industry and production attendant upon war. Whether the output is diminished in total value or not, its nature will no doubt be partially changed, e.g., factories which in peace time produced steel rails will now

produce shells and guns. This, however, need not be taken into account here, as in either case the output will be brought into the national income at its money value.

It is conceivable that a war might actually increase the total value of the national output during its continuance, through the speeding up of production and through greater industry being imposed on the population. It is hardly likely, however, that this effect, if it happened, would counterbalance the conditions making against production, and it is safe to say that nearly always a war will bring about to a greater or less extent a reduction in the total value of a nation's output.

Let us now suppose that in the case of Utopia its revenue from foreign investments is not affected at all by the war, that its earnings from abroad are diminished by half, that is, they fall from £40,000,000 to £20,000,000 a year, and that the annual value of its national output is reduced during war time from £400,000,000 to £350,000,000. Its total annual income during the war will then be £430,000,000 only. Say that in the first year the Utopian Government has to spend £100,000,000 on the war. At the same time the Utopian nation reduces its annual living expenses from £350,000,000 to £280,000,000, partly through the general observance of economy and the cutting off of expenditure on luxuries, partly through the living expenses of the men in the field being reckoned as part of the war expenses. The living expenses of the Utopian nation, plus its war expenses, will thus amount to £380,000,000 against an income of £430,000,000. There will be a surplus of £50,000,000. It will be remembered that in peace time Utopia spent £100,000,000 annually on keeping up and improving her national plant and put £50,000,000 annually into foreign investments. As she now only has £50,000,000 of national income left over, she must reduce her expenditure on "betterments" in Utopia itself by one-half and even then she will have no balance left to invest abroad in that year. If for any reason she should wish or be obliged to lend money abroad that year, say to the extent of £10,000,000, her expenditure on domestic "betterments" would have to be reduced to £40,000,000.

Say that in the second year of the war the cost rises to

£150,000,000. The Utopian nation, by still more rigid economy, brings down its living expenses to £250,000,000. Its income remaining as before, it has a total expenditure that year of £400,000,000 against an income of £430,000,000. There is still £30,000,000 left for maintenance of the national plant, but nothing for foreign investments. In the third year the war expenditure rises to £180,000,000. The nation cannot or will not reduce its living expenses below £250,000,000. The income remaining the same as before, there is no margin at all left for "betterments." It is certain that a nation like Utopia cannot go on for even one year without spending a large sum on the maintenance of its national plant, even if nothing be spent on improvements. But, as the whole amount of the national income is now absorbed by (*a*) The current living expenses of the nation, (*b*) The special war expenses, how can any further expenditure be met? It can only be done by meeting part of the war expenditure not out of national income, but from one of the other two sources indicated previously, i.e., from the capital or accumulated wealth of the nation, or from borrowing.

Before we proceed to consider these other two sources, it may again be observed that a nation may pay for a war out of income, although the State pays for it by borrowing. Thus, in the illustration given above, the Utopian nation is supposed to find £100,000,000 for the first year of the war and £150,000,000 for the second year out of the national income. But the Utopian Government may raise the whole sum required in both years not by taxation but by a loan. It would borrow the money from its own subjects, who would lend it the surplus of their income. At the end of the second year, the State of Utopia has increased its debt by £250,000,000, but the debt is due to its own subjects, and in a computation of national wealth the two entries cancel one another. From that point of view the result is just the same as if the Government had paid for the war, as it went along, by taxation instead of by raising a loan. In practice, of course, it would be impossible to impose or distribute equitably so large an addition to the annual taxes of the country, and for that reason, as well as for others which it is not necessary to speak of here,

a modern state would certainly meet the greater part of its war expenditure by borrowing, even though the whole of the money borrowed were provided out of the current national income.

Source B. National Capital—

A nation's capital at any moment may be defined as the whole mass of its accumulated wealth. This will consist of:

(*a*) Fixed assets, such as land, buildings, machinery, railways, roads, canals, irrigation systems, etc., etc.

(*b*) Live stock and stocks of raw material and manufactured goods of every kind, including articles of art and luxury.

(*c*) Gold and silver coin or bullion.

(*d*) Debts owing by foreign nations.

The first three items under modern conditions will be to a large extent represented by pieces of paper in the form of shares, or bonds, or bank-notes, which, of course, are not wealth in themselves, but are tokens or evidences of property in wealth.

The fourth item is also generally represented by shares, or bonds, which are evidences of debts due by other countries or of property owned in other countries. To some extent it may also be represented by bills and other short term instruments, by banking entries or simply by entries in merchants' books, all of which are evidences of floating debts due from abroad.

When a country goes to war, to what extent can it draw upon its capital or accumulated wealth to defray the expenses of the war? Plainly, it can only do so either by using the actual articles of which its capital consists or by selling or pledging them and using the proceeds to meet the expenses of war.

The first method, that is, the direct use of its accumulated wealth, is limited by the nature of the wealth. Live stock and stocks of metals or clothing or leather or food or other raw material and manufactured articles can be used up and not replaced or only partly replaced. Coin and bullion can be used to purchase from abroad goods wanted either for the war

or for the civil population. But with that we come to an end of the direct use of the nation's accumulated wealth for warlike purposes. The fixed assets, such as land and buildings, the articles of art and luxury, and the pieces of paper representing debts due from foreign countries, can only be made useful to meet warlike expenditure, if they can be sold or pledged abroad. In the present war, for example, an Englishman may sell a picture by Titian to an inhabitant of the United States. He thus establishes a credit in the United States for the price of the picture, say, £10,000. He invests this sum in the British War Loan and the British Government buys £10,000 worth of shells or of clothing or of wheat from America. The payment for this gives America a credit for £10,000 in London, which by the ordinary process of exchange cancels the credit established in America by the seller of the picture. In this way a part of Great Britain's accumulated wealth, namely a Titian picture, has been realized and the proceeds devoted to war expenditure.

Instead of selling a picture our Englishman might sell on the New York Market a parcel of American Municipal Bonds or American Railway Shares; or, if New York was willing to purchase, he might sell Japanese Government Stock or the shares of South American Tramways. In either case, he would be realizing a part of the debt due to Great Britain by foreign countries. If he contributed the proceeds to war expenditure, either in the form of taxation or by taking up stock in a British War Loan, the immediate result of the process would be that Great Britain would have used a portion of its accumulated wealth towards meeting its current expenditure on war.

In the first example quoted it was an article of luxury that was converted and the proceeds used for warlike expenditure; in the second it was a debt due from a foreign country. But our Englishman might also sell abroad an English Railway Debenture or conceivably might raise a mortgage in New York or in Amsterdam on a building belonging to him in the City of London, and the proceeds as before might flow into the war-chest of Great Britian. In this case a part of the country's fixed assets would be sold or pledged. The asset would remain in Great Britain, it would not disappear from the country

altogether like the Titian or the American Bond, but there would be an obligation laid upon it involving a charge on the country's future earnings. It will be seen that this particular way of using capital comes very close to the third method of providing for war expenditure which has been indicated, namely, that of borrowing abroad. It is only distinguished from it inasmuch as it consists in the pledging of particular assets by private individuals, whereas borrowing abroad is taken to mean the pledging by the national Government not of any particular assets, but of the country's general credit. In practice it is not likely that the raising of money from abroad against fixed assets in a country at war will be carried on to any great extent. For it can only be done if foreigners are willing to invest money on the security of fixed assets in a country at war, and it is not likely that they will be.

It will be noted that in all the instances quoted the sale is spoken of as being made abroad. If the sale is made within the country at war, the resources of that country are not increased. If the Englishman sells his Titian or his American shares to another Englishman, he may contribute the money to the war by paying it in taxation or lending it to the Government, but he has deprived the purchaser of the power to do the same thing.

It was stated above that war expenditure might be partly defrayed out of a nation's capital through stocks of raw material and manufactured goods being used up and not replaced. For instance, a country might carry in ordinary times six months' stock of raw material for its principal manufactures and six months' supply of manufactured goods for its principal trading customers. During the war it might and probably would allow these stocks to run down. Suppose they ran down to the extent of one-half in each case. At the end of the war the country would find itself with this particular part of its capital diminished by one-half and it would find it necessary to replace this used-up capital before it could again conduct its business on a proper footing. Live stock, again, is likely to be used up in the same way. So is shipping.

In the case of a long war a somewhat similar process may happen in relation to many of a country's fixed assets, e.g.,

buildings, railway lines and equipment, land, etc. During the war the activities and resources of the nation will be turned to producing articles of immediate consumption, either for military use, or for the supply of the civil population. It is likely that there may not be enough left over to maintain the plant of the country, as it is called, in good condition. For a few months this will not matter, but, if the war is prolonged it will be found at the end of it that the plant of the country has run down and needs heavy expenditure to put it again into a state of efficiency. Suppose, for example, that the railway companies of a country in an ordinary year spend £25,000,000 on the maintenance of their roads and equipment, and suppose that during a war of two years, owing to the difficulty in raising capital for such purposes, they should only spend £5,000,000 each year on maintenance. At the end of the two years the capital value of the railway system of the country would be impaired to the extent of £40,000,000, and it may be said that the national capital had been diminished to that extent in the process of paying for the war.

It is impossible to calculate now to what extent the plant of Great Britain or of the other countries at war is being impaired through the retrenchment of ordinary expenditure on maintenance. But there is no doubt that deterioration is going on in many directions, and in this respect all the warring nations are, in a manner of speaking, paying part of their war expenses out of capital.

Source C. Foreign Loans—

This method of paying for a war does not require a long description. It is restricted to the case where the Government of a belligerent country is able to get a loan taken up by the investors of some foreign country. The belligerent Government borrows money abroad on its national credit. The same effect would be produced if individuals belonging to the belligerent nation were to borrow money from abroad, and then lend it to their own Government or pay it out in taxes or in other ways use it to support the expense of the war. But since it is in most cases impossible for a private person to borrow abroad simply on his credit, but he is obliged, if

he wants to raise money, to sell or to pledge some tangible asset, it is permissible to say that money obtained privately from abroad will nearly all be obtained by the realization of capital, and thus will come under the heading of Source B, and that the use of Source C is restricted to the Governments of the nations at war. An example of the use of this source was afforded in the Russo-Japanese War, when both the belligerent Governments raised foreign loans. And again in the Balkan War. In the present war, most of the nations in a position to lend money are themselves combatant, and so far there has been no attempt at raising a foreign loan on a large scale. There have been loans from one Allied Government to another, but these are presumably temporary. Both France and Germany have, moreover, sold Treasury Notes in New York to pay for their American purchases, but only in comparatively small amounts.

II. How Wars are Financed

Having examined the different sources from which a nation may provide for the expense of a war, we must consider the financial methods which may be used to raise the money. These have to be settled by the Government of the country at war, which may determine to raise the means it requires for carrying on the war either by taxation or by borrowing. In the Middle Ages, when the possibilities of taxation were limited and national borrowing had not yet been developed, it was the practice of kings to accumulate a treasure in gold, which they could use when they went to war. Such methods are no longer possible, and, if they were possible, would be wasteful. The so-called war-chests which are sometimes accumulated by modern governments are not intended to meet the expenses of a protracted war, for which they are quite insufficient, but to supply a reserve of ready cash to be used in an emergency, particularly for the heavy mobilization expenses and demands of the first few weeks.

Taxation is inadequate and unsuitable as a means to meet the expense of a great war. In such a case as that described above, where a nation actually provides the whole cost of a war out of its current income, it would be possible in theory for

the Government to raise the whole sum in the form of current taxation. Thus at the end of the war the State would have incurred no fresh debt. But in practice so huge and sudden an addition to the taxes would be intensely unpopular and would wear the appearance of confiscation, and thus damage national credit. A modern Government, therefore, is certain to provide most of its war expenses by borrowing, even though it borrows from its own subjects and borrows nothing but the surplus of their current income. In that case the nation considered as an aggregate of individuals is lending the money to itself in its collective capacity as a State. The people make the loan and it is the people who ultimately repay it, since interest and principal of the national debt fall on the future taxes. But by proceeding in this way, instead of putting the whole cost on the taxes of one or two years, the burden is spread over a long period and it is much more easy to distribute it without causing discontent.

There is one method in which war expenses can be met by what is really an indirect form of taxation, though it does not bear that appearance on the surface. It is a method more in favour with revolutionary than with regular governments, though, when in great straits, there in no nation which may be able to escape it. It consists in the forced issue of paper money. Say that a Government requires £300,000,000. Instead of raising the taxes or issuing a loan, it may simply use its printing-presses and strike off currency notes to that amount and by declaring them to be legal tender may force them into circulation. Of course it can only force its own subjects to take them, and unless the surplus currency is required for the ordinary internal business of the nation, the currency notes will be depreciated. If there is an undertaking on the part of the Government to redeem them in gold at some future date, their depreciation may be checked by faith in the promise to redeem. But, if the currency is irredeemable, there will be no check to depreciation, until the total value of the volume of currency in issue at any one time has reached the level of the total value of the real currency requirements of the country. Thus prices calculated in the depreciated currency will rise and the holders of currency from time to time will incur a gradually

increasing loss through the diminution in the purchasing power of their currency. This in effect amounts to taxation, the incidence of which is uncertain and irregular.

Although at first sight the above may seem an easy and attractive way of raising money, the ulterior effects of deranging the currency system of a country are so serious that no Government with financial foresight would adopt this method to any great extent, unless under the pressure of absolute necessity. It was adopted, as is well known, by the revolutionary Government in France at the end of the eighteenth century. It was again adopted by both parties in the Civil War in the United States and it has been a not uncommon device with revolutionary Governments in South America. But it is generally recognized to be a method of last resort.

There is, however, this qualification to be made of the above observations. When a country is at war, it is an observed phenomenon that it requires a much larger amount of currency for its everyday use than in normal times. This may be put down to a combination of causes. In the first place an unusual amount of buying and selling is going on through the addition of war expense to the normal expenditure of the country. Secondly, owing to the element of uncertainty which is introduced by a state of war, business transactions are carried out on a cash basis to a much greater extent than in time of peace, and thus a greater volume of currency is needed for them. Thirdly, there is a pronounced tendency on the part of private persons to hoard their money or at least to keep by them for emergencies a larger sum in cash than they would do in ordinary times. If they hoard gold, it is withdrawn from the currency for the time being and a vacancy is made which can be filled by fresh paper currency. Moreover, it appears that people sometimes hoard the paper currency itself, or at any rate keep a cash reserve in this form.

There may be other causes at work, but the above three can be specially mentioned. At any rate, there is no doubt about the fact that a country at war keeps a much greater volume of currency in internal circulation than the same country does in peace time. The Bank of England's note

circulation in the first week of May was over £38,000,000, against £29,500,000 a year before. In addition there were in circulation £40,000,000 of Treasury currency notes, making a total addition to the paper currency of Great Britain of about £48,500,000 as compared with a year ago. It must be remembered that Great Britain uses the cheque as a substitute for currency much more than any other nation. The excess of paper currency in the other combatant countries is far greater. The note circulation of the Bank of France in the first week of April amounted to the equivalent of £456,000,000 as against £237,000,000 a year ago—an excess of £219,000,000. The Imperial Bank of Germany's statement for the same date shows a note circulation equivalent to £268,000,000, as compared with £110,000,000 a year ago—an excess of £158,000,000. In addition to this there appear to be notes of the new Loan-banks in circulation to the value of about £35,000,000. Thus the total excess of the German paper currency as compared with a year before, amounted to £193,000,000.

In Russia the note circulation of the State Bank at the same date amounted to £319,000,000, as against £161,000,000 a year ago—an excess of £158,000,000.

The phenomenon of an increased demand for internal currency in a country under war conditions gives to a Government, whose credit is good with its own subjects, an opportunity for raising a sum equivalent to the increase in the demand for currency without necessarily causing any depreciation. It will be seen from the figures quoted above that this opportunity has been taken advantage of very fully in Germany, France and Russia. The increased note circulation of the State Banks of the three countries supplies the banks with so much extra money for the cost of printing it, and the additional money is loaned to the respective Governments under the arrangements which they have with the State Banks, and helps to meet their war expenditure. It will be observed that the British Government has only raised a comparatively small sum through the issue of paper currency. Moreover, this sum is really much less than it appears, inasmuch as the Treasury is at present holding a reserve of gold against its issued currency notes up to two-thirds of their value, so that the benefit obtained

by the Government from the issue amounts not to £40,000,000 but to about £13,000,000.

It cannot be said that in any of the countries mentioned the issue of currency has yet been pushed to a point which involves depreciation. It is true that, judged by the test of the foreign exchanges, both German and Russian paper show a serious fall in value. But the foreign exchanges, especially in war time, are affected by other causes than depreciation of domestic currency. Such depreciation, no doubt, would always cause the foreign exchanges to move against a country : but it may move that way without such depreciation. In the case of France, where the expansion of the currency has been greatest of all, the exchange has remained almost at normal, the adverse movement being slight and fully accounted for by reasons unconnected with the currency.

It must be recognized, however, that at the end of the war the excess paper currency which has been issued in the different countries will no longer be required as each country returns to normal conditions of business. It will therefore have to be redeemed, unless the nations concerned are prepared and able to go on using it as a substitute for an equivalent part of their gold currency. For example, we may assume that France, after peace returns, will not require more currency in issue than she had before the war. The excess of £219,000,000, which she now is using and which has been provided by a paper issue, will flow back into the Bank and will have to be redeemed. It might indeed remain in circulation, if an equivalent amount of gold coin were driven out, that is, if the French people were willing and able to substitute a paper for their gold currency for everyday use, to the extent of £219,000,000. But this is not likely. The excess paper currency will therefore have to be redeemed and the French Government will be obliged ultimately to provide the funds with which to redeem it. In the meantime, it has the use of the money, which thus in effect is a loan bearing no interest.

Since ordinary taxation is inadequate and depreciation of currency is to be avoided, it follows that a State loan is the most proper and convenient method by which a Government can meet the expenses of a war. The loan may be raised from

its own subjects, who may find the money out of income, or by realizing their capital, or partly by the one and partly by the other. In this case Sources A and B referred to above, namely the national income and national capital, are drawn upon. Or the loan may be raised abroad, in which case Source C, namely the wealth of other countries, is drawn upon.

The Government borrowing may take the shape of a long-term issue, such as the recent British or German war loans. In this case the Government borrows the money for a long period of years and does not undertake to repay the principal till the end of that period. In the meantime, it has to pay the annual interest on the loan. Or it may take the shape of an issue of Treasury Bills or similar instruments. These represent a short-term loan for six months or a year: and although in special circumstances they can be issued in considerable quantities, they are, of course, merely a temporary expedient. Sooner or later the advances which they represent must be converted into a long-term loan.

What limits are there to the power of a first-class Government to raise loans ?

If it is borrowing abroad, the limit is set by its own credit and in addition, of course, by the power of foreign countries to lend. If Germany alone were engaged in war—say with China—the German Government could no doubt raise loans in Europe, as well as the United States, to almost any extent, by offering sufficiently attractive terms. But in the present war most of the rich countries are engaged as combatants: the only neutral which has power to lend on a large scale is the United States ; and so far, except for a small issue of French and German Treasury Notes, none of the belligerent Governments has tried to borrow there.

But when a Government borrows from its own subjects, its credit is practically inexhaustible and the limit must be set by their power to lend. The processes of modern finance are so intricate and the creation of credit through the machinery of the banks is so easy, that the layman is sometimes inclined to believe that there is no limit and that a Government can go on borrowing for ever, if it makes the necessary arrangements with the banks. This belief is apparently being cultivated

in Germany, to judge by the recommendations of a circular sent out by the Wolff Agency, which is said to have been approved if not instigated by Dr. Helfferich, the Minister of Finance. This circular appealed to the savings banks and others to subscribe liberally to the recent German War Loan. It pointed out how mistaken those investors were who thought that because they had invested their liquid resources in the first loan they could not subscribe for the second. On the contrary, the scrip of the first loan was an excellent basis for borrowing money from the ordinary banks or the loan-banks, in order to buy the second.

At first sight not only does the process advised in this circular appear an excellent way of assuring the success of the War Loan, but there seems no reason why it should not be repeated *ad infinitum*. The patriotic German might subscribe his 10,000 marks to the first War Loan and obtain an advance against it : subscribe this advance to a new loan and so obtain new scrip, which he would again pledge, and with the new advance so obtained buy yet more scrip, and so on. The offer of the Bank of England to make advances against the scrip of the British War Loan seems to offer similar facilities to the British investor.

But there must be some limit to this chain of progressive borrowing. Let us examine the question more closely by the aid of an imaginary case. Suppose that the private deposits in all the banks of a country, at the outbreak of war, amount to £250,000,000 in value. The Government issues a loan of £250,000,000 which is subscribed for by the private depositors. The immediate result is to transfer the whole of the bank deposits of the country from the credit of private persons to that of the Government. The following month the Government offers another loan of the same amount. The holders of the war loan scrip, following the plan recommended by the Wolff Agency, take their scrip to the banks, who make them an advance against it to its full value. We will suppose, for the sake of clearness, that these advances are made in the form of bank-notes, which the banks have power to issue. The position would be the same, of course, if the advances were made simply by the banks giving credits in their books, against which

cheques could be drawn: but by supposing them to issue notes the course of events is made plainer. With these notes the public takes up the second war loan: the result is that the notes are immediately redeposited in the banks, to the credit of the Government. The third month a further loan of a similar amount is offered and the process repeated: and again the fourth month. At the end of four months the Government has borrowed £1,000,000,000 and there are £750,000,000 of new bank-notes in existence, all of which, together with the original £250,000,000 of deposits, lie in the banks to the credit of the Government (except so far as it has spent that amount). Evidently, except for the original £250,000,000, what the Government has borrowed is a mass of bank-notes created for the purpose and it might have attained the same result in a less roundabout way, by simply printing off the notes and issuing them itself, on its own credit, instead of inviting the banks to do it. It can use the notes, if they are made legal tender, for purchases from and payments to its own subjects. But it cannot force a greater volume of currency into circulation than the business of the country requires. Otherwise, as was explained above, the currency will be depreciated in proportion to the excess. The net result therefore of the process as described above—which is put in an extreme form for the sake of illustration—is simply a depreciation of the currency.

Now let us suppose, what is more likely to happen, that the second loan is issued not a month but a year after the first. By that time the Government will have drawn the proceeds of the first loan out of the banks—still, let us say, in the form of bank-notes—and will have spent them on paying soldiers and officials and on the purchase of munitions of war and food and clothing for the army. The bank-notes given in payment will have been passed from hand to hand and will have found their way back again to the banks. Thus the volume of private deposits will have been reconstituted. When the Government issues its second loan, the reconstituted body of private depositors will be able to take it up, as they did at first, by transferring their deposits to the credit of the Government, and taking war loan scrip in exchange. The volume of currency will not have been inflated at all. This process may be repeated at the end of

the second year and so on. Thus it would seem that the borrowing can be carried on *ad infinitum*. But there are two limitations. First, there must be sufficient time between the loans to allow the proceeds of the first to be expended by the Government, to pass into the hands of private persons, and to filter back to the banks, before the next loan is issued. Otherwise new currency in one form or another, either in form of notes or credits, will have to be created to take up the second loan and there will be inflation.

The second limitation is that the proceeds of the first loan must be so expended that they will actually come back to the banks and reconstitute the volume of private deposits. In other words, the services and material required for the war must all be obtained from the country's own people. It is plain that the people in addition must be producing what they are consuming themselves from day to day. Therefore the limitation amounts to this, that in order for the system of progressive borrowing to go on without a hitch, the nation at war must itself produce all that is required for the war in the way of services and material, over and above the necessities of its daily life. Or if it buys any part of its war material from abroad, it must produce an equivalent to give in exchange. If this condition is fulfilled, the nation can go on fighting indefinitely, as far as finance is concerned, although no doubt its capital will be depreciating the whole time. The Helfferich method may in these conditions be useful, because it enables subscribers to the first loan, who have not got their money back out of the Government expenditure, still to subscribe again to the second loan, by the assistance of the banks. But it should be understood that the advances which the banks make to them, on the security of their scrip, are provided out of the volume of deposits which has been reconstituted out of the expenditure of the first loan, though the deposits may now be in other names. The nation is meeting the cost of the war mainly out of its current income : and the issue of Government loans, the pledging of the scrip to the banks, and the use of the advances so obtained to subscribe to new loans are merely financial machinery.

To put the matter in another way. Say that Germany has

an adult male population of twenty millions, excluding children and quite old men. Say that in the course of the war eight millions of these are taken for military service and another two millions are required for the manufacture of war supplies of every kind. If the remaining ten millions, with the assistance of the women and children and old men, can carry on the business of the country, including not only production, but transport and distribution and services of every kind, so as to supply food and clothing and the other necessaries of life for the whole of the population, combatant and non-combatant, then Germany can go on for an indefinite time, raising internal loans to meet her war expenditure and taking them up from her own resources.

But as soon as the productive activities of the balance of the people, after deducting the soldiers and the armament workers, are insufficient for this purpose, the case is changed. On this hypothesis the total production of Germany becomes insufficient to supply her wants, irrespective of whether she consumes all her products herself or uses a part of them to export abroad in exchange for other articles. If she attempts to increase her import of supplies, she must pay for them. She has, by supposition, no further surplus of commodities, so that she cannot pay in kind. She will have to pay by exporting gold, or by borrowing abroad, or by giving up some saleable part of her accumulated capital. Foreign nations will not take paper currency in payment from her and therefore the issue of bank-notes will not help.

In general conclusion it may be stated that the most convenient, as it is the most usual way of meeting war expenditure, is by means of Government loans. The objection to financial expedients such as those suggested by the Wolff Agency is that they may lead to inflation of currency. So long as this is avoided they have the result of absorbing the surplus income and the floating capital of the nation in war loans.

As a matter of policy it is generally desirable that war loans should be issued on a permanent basis as soon as possible and that the short-term indebtedness should not be allowed to accumulate. In this particular respect German war finance has been better managed than that of the Allies. Germany

has funded the whole of her war expenditure to date by the issue of two great loans. Russia and France have piled up a large floating debt. It would certainly make for financial stability and would probably encourage further saving, if this were funded by the issue of permanent loans. If such an issue is successfully made, the loan passes into the hands of investors who do not look for their capital to be repaid, but only for the annual interest. Floating debt, on the other hand, in the form of Treasury Bills or other short-term instruments, remains in the hands of banks and financial houses, who have no intention of locking up their capital permanently. The existence of a mass of debt of this kind, therefore, may cause instability and uncertainty in the financial situation. The same objection applies to advances made to the Government by a State bank. This method has been largely used by the French Government, the advances of the Bank of France to the State reaching last March the figure of over £180,000,000. A further consideration is that when private investors have used up their free capital in subscribing to a Government loan, they are more likely to make an effort towards fresh saving than if they have large sums in cash lying on deposit in the banks. This effort will be all the stronger if investors only partly pay out of their own money for the scrip they take up, and borrow the balance from the banks: for then they work to clear off the debt. Thus the issue of a State loan in a form which will absorb private deposits as fast as they accumulate makes for industrial thrift. The same cannot be said of an issue of Treasury Bills. The banks take up these in their own name: the deposits are really absorbed, for the banks use them for the purpose: but the private depositor regards his money as still lying at call, and has not the same incentive to save more as he would have if he had invested his money and knew it was tied up.

III. War Costs and their Future Effect

Many calculations have been made of the cost of the war to Europe, ranging from £10,000,000 a day upwards. Sometimes the actual war expenditure of the different Governments is taken as the measure of cost. Some calculators add the loss

of life at the value of so much a life. Some add the material destruction of property in the invaded districts. Some throw in the money which might have been earned during the war by the armies had they been productively employed.

The item of Government expenditure is a definite quantity which can be ascertained with approximate exactness. The item of destruction of property in warfare is also a definite quantity, but is much less easy to ascertain. The other items of loss are simply conjectures. It is impossible to say that all the soldiers engaged would have been productively employed; or that the loss of their productive energy has not been to some extent compensated by increased industry on the part of the non-combatant population; or that decrease of production has not been partly balanced by decrease in consumption. Germany will probably produce less scent during the war than she did before; but if the consumption of scent in Germany diminishes to the same extent, there will be no actual loss of wealth.

In what respects can a nation suffer actual diminution of wealth through war? In what respects will it actually be poorer at the end than at the beginning? We need not go into the question of the additional wealth which it might have accumulated during the period of the war, if there had been no war. In other words, we need not consider the cost of the war, so far as it has been defrayed from surplus national income, but only so far as it has been defrayed from capital. A nation may find itself poorer at the end of a war than at the beginning in respect of one or more of the following:—

(*a*) Reduction of its liquid assets, e.g., stores, material, live stock, coin and bullion, etc., which have been consumed in the war and not replaced.

(*b*) Loss of its foreign investments or any other saleable assets, which it has realized abroad in the course of the war and of which it has spent the proceeds.

(*c*) Foreign indebtedness which has been incurred to help to pay for the war.

(*d*) Depreciation of the national plant and equipment through insufficient sums being spent on its maintenance during the war.

(*e*) Destruction or damage of property in the course of warlike operations.

(*f*) Reduction of the national productive capacity at the end of the war as compared with the beginning. This may be brought about in several ways, e.g., by destruction or damage of the machinery of production and transport; by reduction in the labour force through slaughter of men in battle; by derangement of industrial organization through its conversion to the production of warlike stores, and through disturbances in the organization of labour.

The last two items are important, but no sort of estimate can be formed of them in figures till the war is over. We know that in Belgium and Northern France and Poland and Galicia enormous damage has been done to property. Germany and Great Britain have suffered some damage through losses in their merchant marine. The industrial organization of Great Britain and France and Germany has been seriously deranged. All the belligerent nations have lost a part of their labour force in killed and maimed.

The first four items represent that part of the national expenditure on war which is met out of capital. They are included in the figures of Government war expenditure, but they do not represent the whole of it. For the Government war expenditure is partly met out of the surplus of the current national income. It is only the balance that is met by consumption of stores in hand; by the realization of foreign investments; by borrowing abroad; and by spending on war money which should have been spent on the maintenance of the national plant.

We can ascertain the figures of Government war expenditure at any rate approximately. If we could ascertain to what extent this expenditure was being met out of current national income, the balance would be the portion of war expenditure falling on national capital and would be the same as the sum total of the first four items of loss mentioned above.

We have already estimated the annual income of Great Britain at about £2,300,000,000, of which about £400,000,000 was estimated to be surplus income, devoted either to better-

ment of the national plant or to investment abroad, the remaining £1,900,000,000 being spent in the living expenses of the nation and on maintenance of plant. If these figures are taken as correct and could be supposed to hold good for the period of the war, we might reckon that Great Britain had a surplus national income of £400,000,000 and that by stopping her foreign investments and her internal betterments during war time, she could pay for the war to this extent without encroaching on her accumulated capital. Say that the British Government is spending £900,000,000 a year on the war, including loans to the Allies and to the Dominions. The country would find £400,000,000 of this amount out of income and would have to provide the remaining £500,000,000 by encroaching on its capital in one of the four ways mentioned above. A similar calculation might be made in the case of Germany, whose national income is given at about £2,000,000,000, of which about £400,000,000 is surplus.

But this method of calculation involves two factors of great uncertainty. The first is the extent to which the nation's income is affected by the war, e.g., through the curtailment of its output of wealth, or even through the falling off of its income from foreign investments. It is impossible to ascertain what reduction takes place from these causes in the national income during war time. A second factor, which is even more uncertain, is the extent to which the national living expenses are cut down during war time. The greater the reduction in these, the greater the surplus income ; and if the national living expenses were to be cut down by more than the reduction in the national income, the surplus would be even larger than before. This latter factor is of great importance both in the case of Germany, where national economy in daily expenditure is enforced as an act of discipline, and in France, where the people have a genius for thrift. It is to be feared that in Great Britain less economy is practised ; on the other hand, it is probable that her national income has suffered less reduction than that of either France or Germany.

With these two factors subject to so much variation it would be vain to pretend to draw from the estimates of ordinary annual income and expenditure any definite conclusion about the

surplus income of a country in war time. There is, however, another way in which the matter may be approached, and which may be a better guide, in the case of Great Britain, as to the extent to which she is meeting her war expenses out of capital.

It has been stated that in 1913 British imports were valued at £659,000,000 and her exports at £525,000,000. It was estimated that £190,000,000 of the exports was balanced by new capital loaned abroad. This being deducted, the balance of the exports was £335,000,000. This was £324,000,000 less than the value of the imports. How, then, was this £324,000,000 of imports accounted for? According to the estimate then made it represented payments made to Great Britain by foreign nations for: (*a*) Interest on capital invested abroad, £184,000,000; (*b*) Shipping freights, £100,000,000; (*c*) Banking commissions, etc., £40,000,000. This estimate is not far different from that made recently by Mr. Lloyd George. He estimates our total return from interest on investments, freights, etc., at £350,000,000, instead of the above figure of £324,000,000.

In the quarter ending March 31, 1915, British imports were £208,000,000 in value and her exports and re-exports £106,000,000, leaving a balance of £102,000,000—or at the rate of £408,000,000 a year excess of imports over exports. Mr. Lloyd George's figure is £448,000,000, and we will take that. We can assume that for the time being British lending of capital abroad has stopped, except for the loans made to the Dominion Governments and to Allied Governments. Take these at the rate of £200,000,000 a year—they amounted to £80,000,000 last March. This sum must be added to the balance of imports over exports, which is thus increased to £648,000,000 in the year, if the first quarter is taken as a guide, although a part of the loans already made may appear in the form of exports during the first quarter. To meet this we have the foreign dividends, shipping freights and commissions, which Mr. Lloyd George leaves at £350,000,000. Deducting £350,000,000 from £648,000,000 still leaves a balance of about £300,000,000 to be paid for. How is this being done? It must be by the realization of British capital invested abroad. There is no other way, unless Great Britain were borrowing abroad, which she is not, or were to manage to reduce her

normal imports. We may assume, therefore, that Great Britain in the process of paying for the war will have to realize on her foreign investments at the rate of about £300,000,000 sterling a year.

As an instance of the way this is done, take the City of New York Note issue of $100,000,000 (i.e., about £20,000,000), which fell due last autumn. This was largely held in London and in peace time no doubt the loan would have been renewed in one form or another. As it was, it was called in and paid off, the funds being supplied by a syndicate of New York Bankers: Again, London has in ordinary times a great deal of money out abroad in the form of short-term loans, bills or credits. Since war started, there has been a steady pressure to call these in wherever it was possible. Above all, British investors hold a huge mass of foreign stocks, shares and bonds. By no means all of them are saleable in war time. But among them are American securities estimated to amount to perhaps £1,000,000,000 in value. These or the great part of them are saleable in New York and are actually being sold all the time. America sends the purchase price over to Great Britain in the form of commodities and in this way the extra balance of imports is accounted for.

According to Mr. Lloyd George's statement in the House of Commons, the total expenditure of the British Government, if the war lasts another year, will during that year be about £1,130,000,000. Of this approximately £200,000,000 will be current expenditure, leaving our actual war expenditure at £930,000,000 for the year, of which £200,000,000 will represent loans to our Allies. We have seen above that the nation in paying for this will have to realize its foreign investments at the rate of £300,000,000 a year. This leaves £630,000,000 to be provided for.

We can assume that in war time the nation has stopped its ordinary foreign loans—the special Government loans have been allowed for—and also its expenditure on internal betterments. In peace time it spends £400,000,000 a year in these two directions. The diversion of this sum to meet the war expenditure still leaves a balance of £230,000,000. Assuming that the national income and living expenditure remain the

same—or, at any rate, that there is the same margin between them as in peace time—this sum of £230,000,000 is being provided by Great Britain out of her internal, as distinguished from her foreign, capital. That is, it is being provided either by consuming accumulated stocks and not replacing them, or by cutting down the ordinary annual expenditure on maintenance of the national plant. If the margin between the national income and living expenditure is greater or less now than in peace time—that is, if the surplus income of the nation is greater or less than the £400,000,000 which was given as its normal figure, the balance of the war expenditure to be provided out of internal capital will fall below or rise above the figure of £230,000,000. But in any case we can conclude from the figures given that Great Britain is providing for the war out of her external capital, e.g., her foreign investments, at the rate of about £300,000,000 annually. If the margin between national income and national expenditure is not so large as the figures given above, she will either have to increase still more the sale of her securities or raise foreign loans.

We do not know what the German Government is spending on the war. We know that up to date it has issued two war loans amounting in the aggregate to over £650,000,000. No doubt Germany is financing both Austria and Turkey to some extent. She has borrowed £2,000,000 in America by an issue of Treasury Notes. Germans are also selling their foreign investments. The total value of these has been estimated at £1,000,000,000 sterling. Many of them, e.g., Turkish investments and many South American investments, are not saleable at present. But Germany holds a not inconsiderable amount of American securities, and, since war began, has been selling these steadily. The total amount sold is uncertain. An American authority has estimated that the stocks sold on German account in America during the first eight months of the war amounted to more than £20,000,000 in value and less than £40,000,000.

But Germany, as Mr. Lloyd George has pointed out, is in a different position from this country. She is selling very little abroad. But she is buying little too. Her exports and imports are strangled. The fact that the exchanges are heavily

against her is nevertheless an indication that she has difficulty in meeting her external engagements. Apart from the handicap to her military operations, which we may hope will sooner or later become exceedingly heavy, it is undoubtedly an advantage, financially, not to have to buy from abroad. The greatest difficulties which face the Allies in the financial sphere are those connected with meeting their external obligations.

So far as internal loans are concerned, Germany, it must be remembered, gains by her large population. If a loan of £400,000,000 is to be raised, the average subscriptions of 70,000,000 people need not be nearly as large as the average subscriptions of 45,000,000 people.

French investments abroad have been estimated at £1,500,000,000, but are probably larger. A large portion of them, however, lies in Russia and cannot be sold at the present time, since there is no one to buy. The same applies to her Mexican, Brazilian and Argentine investments. She holds less American securities than Germany—far less than England—and these are almost the only securities which can be sold in any quantity, while the war lasts.

France, therefore, is faced with a task of no little difficulty in having to meet the very large external obligations which she is incurring, especially as her export trade is naturally suffering very heavily.

Russia's problem is equally, if not more, difficult. For Russia is in ordinary times a debtor nation, and has normally to pay very large sums abroad in interest on her debt. She is now in the position in which she must buy heavily from abroad and at the same time is restricted by her geographical position from exporting her raw materials.

It is for these reasons that England will have to find large sums of money for her Allies.

An indication of the extent to which the United States is financing the war through the repurchase of its own securities from the belligerent countries, may be obtained from the trade figures of that country. In the four months ending March 31 last the exports of the United States exceeded the imports in value by $595,000,000, that is £119,000,000. This is at the rate of £357,000,000 a year. The average excess of

United States exports over imports for three years before the war was about £100,000,000. At present, therefore, there is an abnormal excess of exports at the rate of about £257,000,000 a year. It may be assumed that with this excess of exports the United States is buying back American securities from the belligerent nations.

Mr. Lloyd George said in Parliament that for the year ending December 31, 1915, the war expenditure of the Allies would not fall far short of £2,000,000,000. This implies that Great Britain, France and Russia will on the average each be spending at the rate of between £600,000,000 and £700,000,000 a year on the war. Mr. Lloyd George indicated that Great Britain would be spending from £100,000,000 to £150,000,000 a year more than either of the other two. Let us assume that the war lasts for two years. At the end of that time we may expect to see Great Britain with an addition to her national debt of, say, £1,400,000,000, and France and Russia each with an additional debt of £1,200,000,000. Germany has raised over £650,000,000 in nine months—that is at the rate of £1,800,000,000 in the two years, part of which no doubt may be on account of Austria. The total increase in the indebtedness of the two countries will certainly not be short of £2,200,000,000. Leaving out of account the smaller Powers involved, that means a total increase in the national debts of the five Great Powers amounting to £6,000,000,000 in all.

As far as Great Britain, France and Germany are concerned, their new debts will be owing mainly, if not entirely, to their own nationals. A proportion of the new Russian debt will probably be held in France and England, while a part of the Austrian share of new debt will be held in Germany.

British investors will own £1,400,000,000 of British Government loan, probably a substantial amount of Russian loan, perhaps some French loan. On the other hand, they will have disposed of at least £500,000,000 and perhaps much more of their holding of foreign, principally American, investments. German investors will hold £2,000,000,000 of new German and Austrian loan and will have disposed of all their saleable American investments. French investors will own the greater

part, if not all, of the £1,200,000,000 of new French loan and a part of the new Russian debt, and will probably have sold all of their foreign investments for which they can find a market.

The United States, which by the export of food, raw materials and manufactured supplies to Europe at high prices is piling up a huge credit balance, will have taken payment for this by cancelling its former loans abroad and by buying back American stock and bonds from Europe ; to a smaller extent perhaps it will settle the balances by making direct loans in one form or another to some or all of the combatant countries. It will have bought back American stocks to the extent probably of at least £600,000,000.

In Great Britain the national plant and equipment will probably have suffered by the cessation of expenditure on maintenance. As we saw above, it seems certain that even at the present moment Great Britain is paying part of her war expenditure by cutting down the amount which she spends on the maintenance of her national plant in time of peace.

France and Germany will suffer in this way still more, since they have not, to the same extent as Great Britain has, the opportunity of paying by realization of foreign investments for that part of their war expenditure which must be provided out of national capital. On the other hand, Germany is likely to gain, at any rate over this country, by the greater, probably far greater, economy of her people.

In all the districts invaded by the enemy there will be a large amount of actual destruction to repair. The making good of this and of the deterioration in the national plants will require a large immediate expenditure, part of which, at any rate, will have to be found by the Governments concerned.

In all the belligerent countries there will be an inflation of paper currency, owing to the greater use of currency in war time. This surplus currency will have to be redeemed, this constituting another addition to the war debt. If it is allowed to remain in circulation, after it ceases to be required, a depreciation of the currency will follow, with the evils which ordinarily attend it. The excess paper currency might indeed

be allowed to remain in circulation without harm, if the nations concerned were prepared to substitute it for their metallic currency. But it is more than doubtful if they can do this, and even if they could, the rest of the world would not be able to absorb the precious metals which would be given up.

Special provision will have to be made for the reconstitution of Belgium. Regard being had to this, as well as to the other items mentioned above, it is a moderate calculation to say that the addition to the debts of the five Great Powers at the end of two years' war will reach a total of £7,000,000,000. At five per cent this means an annual interest charge of £350,000,000 a year. Beyond this there will be pension charges, which on the most modest scale can hardly amount to less than £100,000,000 a year for the five countries. In all, the additional revenue required to meet the direct charges arising out of the war will thus amount to £450,000,000 annually, divided among the five leading nations. How far these nations will be able to raise this additional revenue, and at the same time maintain their former scale of civil and military expenditure, is a matter which it is beyond the scope of this article to discuss.

The inflation of currency—for redemption is not likely to be immediate—and the scarcity of goods—for the output of articles useful for peace must for some time after the end of war be less than in normal times—will cause high prices to prevail. But the recuperative powers of the modern industrial system are very great. With the machinery and methods now in use production can and will be rapidly increased. The prevalence of high prices will be a stimulus to this. On the other hand, high taxation will enforce economy in consumption. High interest rates on capital will add to the burden which industry will have to carry, a burden which after a time will begin to be severely felt.

As the pendulum always swings too far, it is to be expected that the machinery of production will not only be replaced but extended, and that the years of replacement will be followed by an era of over-production, low prices and financial collapse.

In these matters, however, the course of affairs can only be guessed at. The probability is that there will be a time

of rapid ebb and flow in financial matters. This would naturally be accompanied with occasional crashes. Up to the present the machinery of credit, through which the world's business is conducted, seems to have been wonderfully little disturbed by the war and has shown itself capable of quicker adaptation than could have been believed. It does not follow, however, that this state of things will continue, and it must be remembered that the machinery of credit, which is mainly psychological, is just as essential to the conduct of trade and the material well-being of the world as the machinery of production or the machinery of transportation.

One factor which must not be left out of account is the possibility of social unrest and labour troubles arising after the war. It is difficult to say in what state of mind the populations of Europe will be left. It has been suggested that the war may produce a spirit of earnestness. But by bringing a mass of men close to the primitive facts of life it may also awaken the spirit which questions existing conventions; and the modern industrial system, like any other system of organization, depends on the great majority of mankind accepting established conventions without question.

On the other side, again, it is possible that the desire to repair material losses may be a governing factor in men's minds for some years and may prevent agitation towards new social experiments. The chances for this are better in a country where property is widely distributed such as France, than in a country where the mass of the population own nothing and live entirely by their labour from day to day.

In the building up of industry after the war Germany will have an advantage from the docility with which her people submit to organization for a given end. Great Britain, which has no advantage on either point, will have to trust to the common-sense of her people and to the individual energy and initiative which are found here more often than elsewhere and which in industrial matters compensate for many weaknesses.

IV. The Government's Duty

The foregoing analysis brings into prominence the huge magnitude of the financial task imposed upon this country

and the vital necessity both the Government and every member of the community are under, of leaving nothing undone which may in any way contribute to its proper fulfilment.

Let us repeat the facts. Unlike Germany, which is more self-supporting, France, Russia and Great Britain are purchasing and must purchase from abroad supplies of all kinds in enormous quantities ; Great Britain and France must purchase food supplies and raw materials ; all three countries must purchase munitions of every kind and particularly shells in ever-increasing quantities. The huge bill to the countries from which these materials are bought, must be paid for. It can be paid for only by the export of goods, or by turning over to these countries the interest due on foreign investments, or the freight and commission earned or by the sale of foreign investments or by raising foreign loans or by shipping bullion.

Russia's export trade is practically stopped ; she has no foreign investments ; she earns very little freight or commission ; she has very large sums already to pay to other countries for interest on Government loans ; there are great difficulties in her raising a loan in the United States ; there is left only this country to which she can turn.

France's export trade, too, is enormously impeded ; she has not a very large amount of foreign securities of a class which can now be sold ; she, too, must therefore look to us for assistance in meeting her external engagements. Mr. Lloyd George puts our loans to our Dominions and Allies at £200,000,000. Before the end of the war it may be much larger.

What, then, is the position of the country. It was shown above that on the basis of the figures now available, and after making liberal and even optimistic deductions in respect of our earnings in the way of interest on foreign investments, shipping freights and commissions, we shall have a balance against us of £300,000,000 this year, which must be met by the sale of foreign investments. This will be difficult, and in time to come may become impossible. A further alternative is to raise a large loan in the United States. There are great difficulties here too, and in any case only a certain amount could be raised.

There is one other way, and one only, by which the balance against us can be reduced, and that is by most rigid economy throughout the whole community—such economy as is now being practised by the German people. Every pound's worth of food wasted means a pound's more import, a pound more in the bill against this country and probably a pound more of our vital gold reserve exported. But while waste is unpardonable, to stop mere waste is not enough. We ought to import only absolute necessities, either munitions of war, or raw material for our exports, or food and other supplies which we can by no means dispense with. Let us repeat that every pound's worth unnecessarily imported is so much added to our burden, reduces by so much the money available for subscribing to Government loans, contributes by so much to the difficulty of keeping our gold reserve and our system of credit intact, and makes it by so much harder and more expensive to attain our vital supplies of ammunition. The more difficult it is to pay our debts, the more the exchanges will go against us, and the more we must pay for all our imports. Russia is at this moment paying 20 per cent higher than normal for everything she is buying abroad : and Germany almost as much.

It is the duty of the Government to bring these facts home plainly to every citizen of this country. There is too much extravagance and waste both by private individuals and by the Government ; there have been in the past mischievous ideas spread abroad about the country's "bottomless purse" ; the high wages now being paid are a direct incentive to spending. The Government would perform a great work if they could by some means encourage and popularize the investment of savings. It should be recognized by every man and woman in the country that rigid economy is vital in order that the country may be able both to pay its debts abroad and subscribe successfully to the enormous loans which will have to be raised in this country. Not the least valuable service that can be rendered to our cause is the practice of economy, and that service can be rendered by every man and every woman of whatever age and strength.

V

ENGLAND'S FINANCIAL TASK

(SEPTEMBER, 1915)

I. ENGLAND AND GERMANY: AN ALLEGORY

Once upon a time there were two rich men who fell into a dispute as to the nature of wealth and which of them was the richer. They both possessed large estates of land, mines, and factories, and both had many retainers and employees. But there was this difference between them. The one had the bigger estate and more than one-third more the number of employees; the other had a smaller estate and fewer employees, but he had inherited from his father great personal wealth in the form of investments and securities of all kinds, on the income from which he had been accustomed to live very comfortably. The first man claimed he was the richer, because he had a larger estate and more servants; the second because while his estate was smaller, he had always had a larger income to spend than the first. They decided to settle the dispute in a peculiar way. They agreed to enter upon a shooting competition. Whichever could shoot away most shot and shell for the longest time in his park without exhausting his resources was to be adjudged the richer. One condition, however, was agreed upon. Since the first man had much the larger estate he was to find, if he could, within his estate all the materials for his guns and shells; whereas the other, with the smaller estate, was free to buy materials, if he could, from his neighbours.

The first man, realizing that he must rely wholly on his own resources—for he knew that his estate could do no more than produce the barest necessities of life for himself and his em-

ployees, if at the same time it were to produce also a sufficient quantity of guns and shells—arranged immediately that all his employees should be turned on to producing either guns and shells or the necessaries of life. There were many who were, in normal times, producing comforts and luxuries for himself or attending to the estate in one way or another. Every one of them was turned on to shell-making. It is true that this meant that the estate went largely to ruin. No improvements were made; no fences, gates, buildings, or roads repaired; life became harder and harder for those living on the estate. But they were accustomed to obedience and discipline, and they did not grumble. Meanwhile, by dint of all—men, women, and children—working their hardest, they produced just enough to live on and clothe themselves with, while all the rest of their energies were devoted to making guns and shells for their employer. The latter had only one doubt in his mind. Could the estate continue to find indefinitely all the raw materials necessary to make the guns and shells required? If it could, then it was clear to him that the length of time he could last out would depend wholly on the spirit and determination of his people, on their willingness to go on producing guns and shells, and on their readiness to undergo privations.

The second man proceeded on a different plan. He was quite certain from the start that he could easily win. He had always been so much richer than his competitor. The latter had never had much spare capital, and had always put whatever money he made back into his estate; while he, on the contrary, had always had money to spend on his own and his employees' comforts and even to lend to his neighbours. Besides, he thought himself very clever at having made the condition that his competitor must buy nothing from his neighbours. He did not believe all the necessary materials could be found on the estate. If his belief was correct, he must undoubtedly win.

He did not, therefore, at first trouble to disturb the ordinary way of life of more of his men than he could help. He did not think it either necessary or desirable to cut them down to the bare necessities of life like his competitor or to stop the ordinary work of keeping up and repairing the estate. His

men had always been used to good living, and it might be too sudden a change for them to bear cheerfully.

A good many of his men were, therefore, still employed on the usual work of the estate and also on making a thousand and one things, not necessary indeed to life, but still comforts to which he and his people were accustomed. This meant, of course, that while his estate was kept up and life went on as usual, the number of men he could turn on to making guns and shells was reduced. This, however, did not trouble him, since he intended to buy from his neighbours more than enough to make up. He was always accustomed to trade largely with his neighbours and to exchange a large portion of the produce of his estate with their produce. He continued to do so now, and, in fact, bought more and more largely from them, not only guns and shells, but everything else. This he did not find quite so easy to do as usual, since, although not nearly to the same extent as his competitor, he had had to turn a good many of his men off their ordinary productive work on to gun and shell making, and therefore he had not as much produce as usual to exchange with his neighbours. But this, too, did not trouble him. He had a very large number of stocks and shares which his father had left him, and, though he was sorry to part with them, he intended to sell them gradually to his neighbours and so find for a long time to come the money he wanted.

Time flowed by. It seemed that his competitor's estate was somehow providing all the material necessary. It had become a regular arsenal. There was no one who was not engaged in either making clothes, guns, or shells, or in growing foodstuffs. The competition was going to be longer than he thought. But what with his own guns and shells and those he was buying abroad, he would certainly, he thought, have as many as his opponent. Gradually, however, it became evident that things were not going to turn out exactly as he had expected. He found that a lot of his stocks and shares were not the kind his neighbours wanted to buy. Meanwhile he had ordered from them enormous quantities of guns and shells and had, unfortunately, actually increased the amount he usually bought from them in the way of food and articles of luxury. He began

to wonder what he would be able to offer them in exchange, if his opponent was to manage to go on for a long time. His estate was producing less, not more, since many of his men were shell-making, and although he had still much wealth he had not disposed of, he could forcsee the time when he would have come to the end of his saleable securities. His neighbours would then certainly make difficulties about supplying him. They would not give him their goods before actually receiving his in return and would refuse to give him credit. He thought of asking them to make arrangements whereby they should wait until after the competition was over for payment, but he was not sure whether they would agree to trust him so far, since both he and his opponent were obviously squandering their wealth in an absurd manner. What was he to do? He still believed his opponent would before long run out of raw materials and would get so disturbed about the neglect of his estate as to want to stop. But he could not rely on that. Meanwhile his own employees were not producing enough shells by themselves to keep up the competition. Nor was his estate capable of producing enough food by itself alone for the livelihood of his employees. He had not insisted on increasing the production of his estate, because it had always seemed simpler to buy from his neighbours. It would be awkward now, if he were pushed for the means to buy what he wanted. He might at a pinch always have enough produce to exchange to buy the food he must have. But would there be enough to buy shells as well? Obviously, if he went on as he was, and the time came suddenly when he could buy no more guns and shells from his neighbours, he would be in trouble. He must clearly make a change. He must insist on all his employees consuming as little of the produce of the estate as possible. They must live on the barest necessities, in order that he might have more over to exchange with his neighbours for the things he must have for them. He must take off their work all the men who were engaged in producing things which were not absolutely necessary, and put them on to making shells or increasing the production of food or cloth. If he had started earlier he could have done all this more easily. It was not yet too late, though much valuable

time was lost. But all depended on whether his employees were ready so drastically to change their mode of life, and to suffer and to continue to suffer the hardships and privations which were bound to follow. On that and that alone everything hung. It was clear that, if the struggle were to be prolonged to the point of exhaustion, wealth would be measured and victory determined not only by material resources, but by energy, singleness of mind, abstinence, and endurance.

II. The Two Financial Problems

The war is becoming a war of exhaustion. As each month goes by the financial aspect of the war and its financial and economic results will come more and more into prominence. The balance will incline more and more in favour of those countries whose resources are greatest, which can find to the largest extent within themselves the means of sustaining the struggle, and which have learnt by self-discipline and organization to direct all their national energies at the highest pressure towards the objects of the war, to eschew all production and all expenditure, whether national or personal, which tends to divert energies and savings away from national ends towards meeting the mere luxuries, the comforts and unessential wants of individual citizens. All the nations at war are growing rapidly poorer. A nation cannot, any more than an individual, continue for ever in reckless and wasteful expenditure. Yet for a self-contained nation, which can produce enough to meet at least the barest wants of the civilian population and to provide munitions of war, complete exhaustion can be long postponed. A nation which is not self-contained is in a different case. If it must buy from abroad, it must pay for what it buys in something which the selling nations value, whether goods, gold, or securities. If it can produce exports to pay for its imports, or if it can find liquid and saleable capital, such as its holding of foreign securities, sufficient to meet its debts, well and good. If it cannot, the time will soon come when it will be difficult and may become impossible for it to purchase from abroad. It will then be faced by the question whether it can by an economic revolution, both industrial and agricultural, compel itself to produce within

its own borders all or nearly all it wants to maintain the struggle. Such a revolution has been forced by our Fleet upon Germany and Austria. Economic and financial stress is bringing face to face with it more than one of the Allies.

The financial problems before all the belligerents are, speaking broadly, identical. The first concerns particularly the respective Governments. They are incurring huge expenditure; their credit is being more and more strained; how are they to raise from their people the immense sums required? The second concerns the financial position of each nation as a whole, including its Government, in relation to other nations. Most belligerent nations, the Allies to an enormously greater degree than their opponents, are buying from foreign countries far more than they can pay for by the ordinary means at their disposal. They usually pay by exports. But their exports have to a great extent ceased. How are they to pay? The question is of vital importance. A man who buys what he cannot pay for is a bankrupt. If, finding himself near Queer Street, he can effect a revolution in his way of life and live on his own resources, he can recover. If he cannot live on his own resources and yet cannot pay for what he must have, his position is clearly not enviable. A nation is not different.

III. Internal Expenditure

Let us consider first the problem of our internal expenditure. Not long after the war started Mr. Lloyd George said that our daily expenditure on the war was £750,000, but that this was a diminishing rather than an increasing figure. A few days ago Mr. Asquith stated in Parliament that during the first seventeen days of July the Government's expenditure amounted to £54,190,000, or well over £3,000,000 a day. So much for official forecasts. Even now our expenditure is increasing day by day. We are buying more shells and paying more for each shell; we are enlisting more men; we are lending more and more to other nations; in every direction our expenditure is going up. It is not the least unlikely that in a short time it will be £4,000,000 a day, or at the rate of £1,460,000,000 a year. If we estimate that our expenditure in the next twelve months will not rise higher than £3,500,000

a day—though it almost certainly will—our annual expenditure will be about £1,300,000,000. As our revenue is estimated at well under £300,000,000, we may safely assume that we shall have to raise £1,000,000,000 by loans each year, and probably more. In other words, we have to repeat every six months the tremendous effort of the recent war loan. Every six months the nation must lend the Government another £500,000,000.

Let us repeat again the salient figures on this subject, quoted in the two preceding articles.

The annual income of Great Britain is estimated roughly at £2,300,000,000. About £1,900,000,000 is spent on living expenses and maintenance of the nation's plant. The balance of £400,000,000 represents savings, devoted in normal times either to the betterment of plant or to investment abroad. Now, if all betterment and investment abroad are stopped—and they cannot be entirely—and if the nation's income remains as large—which is hardly likely—there remains £400,000,000 out of income for war expenses. If we take our war expenditure, over and above our ordinary expenditure of £200,000,000, at £1,100,000,000, we are left with a deficit of certainly not less than £700,000,000 to be met either out of capital or out of current savings. If it is met out of capital, that capital must either be liquidated by being sold to foreigners or its owners must be able, by borrowing against it in this country, to turn it into "money," which they can lend to the Government, a process likely to end in a dangerous inflation of credit. Already the banks' deposits in this country were on June 30 not far short of £200,000,000 higher than on June 30, 1914, representing mainly not increased wealth, but inflation of credit. The Government is spending on the war more than half the nation's whole gross income. Nothing like this has ever been known before. It has been estimated that in the Napoleonic times expenditure probably never rose beyond one-sixth of the national income.

The war expenditure of all the belligerents is gigantic, and for all of them, therefore, the most rigid economy is necessary to escape exhaustion. But for two reasons it is more vital for this country than for any other. Both our total expen-

diture and our foreign obligations are undoubtedly greater than those of any other country. It is true, on the other hand, that we started with a much larger supply of available liquid capital, but at the present rate we are rapidly exhausting that portion of it which is saleable. We are quickly exchanging such capital as other nations will purchase—e.g., our American securities—for shot and shell.

It is necessary to emphasize the essential difference between expenditure incurred within this country and expenditure incurred in foreign countries. If the Government has to pay £1,000 to an American for shells, then the American takes £1,000 out of the country and we have the shells. In a week or two the shells have been used and the country is £1,000 poorer. If, on the other hand, the Government pays an Englishman £1,000 for shells, then, though the shells are used as before, the £1,000 is still left in this country and can either be re-lent to the Government or expended on the Englishman's own private purposes. The fact that this country pays every soldier 1*s*. 2*d*. a day, while the German soldier only receives 2½*d*. and the Frenchman only ½*d*. a day, does not mean that the country, as apart from the Government, loses in wealth nearly a shilling a day more than Germany for every soldier under arms. But it does mean that there is an enormously greater transference of wealth from man to man. It does mean that in this country there is far greater temptation to extravagance and increased consumption, which must above all things be avoided. Whether the 1*s*. a day extra we pay is lost to the country depends on whether the soldier saves it to lend it to the Government or squanders it. The same is true of the contractor, the shipowner, the shell-maker, and every other man in the country who is making money out of the war. The money going to him has been taken either by taxation or loan from those who had it. It cannot be got from them again. If the Government is to go on finding the money it wants, it must be re-lent by those to whom it has now gone. If, as it goes from hand to hand, its new possessors continually use it in increased consumption, they are unconsciously betraying their country. They are weakening it and reducing its resources. No man who is better off as the result of the

war has the right to spend the money he has gained on anything but the needs of the state. It is his duty, in fact the least he can do, to lend it again to the state. He could not complain, indeed, if his profits were taken from him by taxation. To lend all they can to the state is the duty of all those—and their number is legion—who are better off as a result of the war—whether they are contractors or ship-owners, or working men or soldiers, or their dependents. England is far more generous to her soldiers than any other country. She cannot continue in this policy unless the whole population—soldiers and their dependents included—respond by economy and saving. Every day not less than £2,000,000 is paid by the Government in the form of payments to contractors, pay to soldiers, separation allowances, and in countless other ways. If those into whose pockets this huge stream of wealth flows save and lend it again to the state, well and good. But, if they spend it on themselves, they are doing no less harm to their country than the man who runs away in battle. Economy is vital, if the Government is to find internally the money it requires. What matters is the actual consumption of goods. The country should be consuming far less than usual; yet, as a matter of fact, it is consuming more.

IV. External Expenditure

Our second and still more pressing problem is that of meeting our foreign obligations. How are we to meet our huge external debts and to help our Allies, none of whom can do so without our aid, to meet theirs? It is a problem about which there is much misunderstanding. Yet the right solution of it is vital to us. A nation which has incurred debts to another nation can only pay those debts by giving in return something which the creditor nation considers intrinsically valuable, whether in services or commodities. It can export goods to it or sell it securities, or it can perform valuable services for it, for which it gets paid—e.g., in the form of freights or banking commissions, or it can send gold to it, or, finally, if its credit is good, it can borrow money from it to pay temporarily what it owes. In any case it must balance its account somehow in one of the

above ways. Whether it is or is not finding difficulty in meeting its obligations is invariably reflected in the foreign exchanges. This problem of the exchanges is to most people a baffling mystery and it is not intended in these pages to try to elucidate it. It is sufficient to say that to the extent a nation in general buys from other nations more than it sells to them, to that extent the exchanges become unfavourable to it. They are an automatic reflection of its position and credit. Take England and the United States as an example. If their debts balance, exchange is at par, or in other words £1 is worth \$4·86⅔ cents. If America owes on balance money to England, £1 is worth more than \$4·86⅔ cents; if England owes on balance money to America, it is worth less. £1 at the date these pages are being written is worth only about \$4·70 cents, and its value has recently been rapidly falling. Take another instance. Russia has now a very unfavourable exchange. £10 are worth usually only about 97 roubles; they are worth now about 149 roubles, or about 52 per cent more. The exchanges are, in fact, unfavourable to all the belligerents. The practical results of an unfavourable exchange are of vital importance. In the first place, the more the exchange moves against a country, the more it has to pay for its imports. Russia is paying 52 per cent more for everything she imports. If a certain kind of shell she is buying from England would have cost her before the war £10, she is paying nearly £15 now. Austria is paying nominally 30 per cent more, though in actual fact her complete lack of credit must make foreign trade practically impossible. Germany is paying about 14 per cent more, France about 6½ per cent, we between 3 and 4 per cent.

But it is not only this extra cost that matters, though that is in itself a very great burden and involves, too, a corresponding rise of prices internally. An unfavourable exchange is a sign that the country in question is finding difficulty in paying. If it continues to buy beyond its means of payment, it finds greater and greater difficulty. Its credit becomes more and more strained, and foreign nations more and more doubtful whether it is wise to trade with it and whether it will be able to meet its obligations. Foreign purchases of any description become more and more difficult and finally

impossible. The debtor nation is then thrown back entirely on its internal resources.

This process has commenced with all belligerent nations. Germany and Austria have indeed been forcibly thrown back on their own resources by the British Fleet. In Germany purchases are far smaller than ours and yet the exchange is about 14 per cent against her, owing largely to the fact that we have stopped practically all her exports. Russia's position is, as already stated, still more unfavourable. At the best of times Russia's balance of trade is against her and is equalized by loans. Now her exports have practically ceased and yet imports are absolutely necessary to her. It is obvious that her difficulty in paying is so great that foreign trade and purchases abroad must now present the most acute difficulties. Yet her needs in the way of munitions are admittedly tremendous. Clearly, since she cannot herself make all she wants, it is hardly possible she can satisfy those needs, unless we can help her financially. In a lesser degree France and Italy are in the same case. There are indications, however, that France is growing more self-supporting. France has always been famed for her recuperative power. It is due not only to the richness of her soil and the rigour of her people, but to their habits of economy as well.

The burden on us is therefore exceedingly heavy, and it is vital that our strength should be sufficient to bear it. It does not matter much to Germany what her exchange goes to, so long as she is not buying much from abroad. Her whole war policy is directed towards and based on self-sufficiency. But not so the Allies. Their war policy is based largely on the purchase of munitions, and even food, from abroad. They are relying on these munitions, and, if the financial position becomes such that they cannot pay for them, the foundations of their policy disappear. It will be a matter of the greatest difficulty for them so to alter it as to become self-sufficient. It may be said, therefore, that, like a pyramid resting on its apex, the external financial position of the Allies rests on the American exchange with this country. It is vital to all the Allies that every means should be used to maintain it.

Figures do not exist from which it is possible to determine

the nation's debit balance in relation to foreign nations. It will certainly not be less than £200,000,000. It may be vastly more. How can this great balance be squared? Let us clear one current misunderstanding out of the way. It cannot be squared or even reduced one penny by any number of loans in this country. The British Government have just raised an internal loan of £600,000,000. That is a wonderful feat, but it has not helped us by one penny to meet our debts to America. It has not reduced our imports or increased our exports. It has given us nothing more of value to exchange with America. It is no good the British Government offering America a credit in the books of the Bank of England. The Americans want something valuable in America. The only ways of paying our debts are either to sell our foreign securities or to induce America to lend us money, or to send her gold, or last and most important, by rigid economy and by increased production in our own country to cut down our imports to the lowest possible figure, to increase our exports, and so reduce the debit balance against us.

To pay our existing debts we must certainly sell a great deal of our American securities. This is, of course, equivalent to the reduction *pro tanto* of our capital wealth. Unfortunately, too, it reduces in future the amount due to us in the form of interest from the United States. Our holdings of foreign securities are generally estimated at nearly £4,000,000,000. But it is most misleading to assume, as Mr. Lloyd George has done, that all this is liquid or available wealth. Far from it. The United States are practically the only people in the world who are now large buyers of securities, and they will only buy American securities. Out of our £4,000,000,000 only about £600,000,000 are invested in the United States, and a good deal of this amount is probably unrealizable. This source of wealth, therefore, is by no means inexhaustible.

Borrowing in America depends not on us, but upon the Americans. To what extent it can be done and on what terms is uncertain, and any such operation requires a combination of great courage and skill on the part of our financial authorities. Rich as we are, we shall before long be spending £1,300,000,000 or £1,400,000,000 a year. No country can continue at that

rate and not strain its credit. In fact, our credit, as evidenced by the American exchange, is suffering already. Much depends on the political course of events. The entry of the United States into the war on our side would enormously lessen the financial strain. America's most valuable contribution to victory would undoubtedly be to lend freely some of her vast financial resources to the Allies. So long as she continues neutral, the difficulties in the way of an adequate loan are great, for the American people have never been very favourably inclined towards foreign securities of any kind. What is absolutely essential, if we are to borrow in the States, is that we should neglect no means of maintaining our credit undiminished.

This brings us to the consideration of our policy in connection with gold exports. In ordinary times, to ship gold is the normal way of balancing accounts and keeping the exchanges level, and it is necessary to inquire whether that is a function which gold cannot still be allowed to fulfil. It is desirable first of all to consider the gold resources of the Allies. The Bank of France has a reserve of £174,000,000, or more than she had a year ago; the Imperial Bank of Russia has £162,000,000, or only £2,000,000 less than a year ago. Our position, too, is very strong, though, as in other things, we have not taken the trouble to organize our strength and show it to the world. A gold reserve is only useful when the world sees it. The international banker looks at the gold reserves of the great national banks and at nothing else. He looks at the returns of the Imperial Bank of Germany and sees a reserve of £114,000,000; he looks at the Bank of England returns and sees £59,000,000. He does not know that we have £29,000,000—far more than is wanted—as a reserve against our currency notes; that the Joint Stock Banks have, it is reported, between £30,000,000 and £40,000,000; that there is a huge untapped reserve in the pockets of the people. He probably forgets that we receive yearly about £40,000,000 of newly mined gold from the British Empire; he certainly forgets that our Dominions have their own gold reserves; that the Australian banks, for instance, hold £40,000,000.

The first task of our Government therefore—a task on which they have not started before a very serious situation has already arisen—is to mobilize our gold reserves, and so strengthen the Bank of England. It would then be apparent how strong our position is, and it would be clear that, if this country, France, and Russia followed a concerted and harmonious policy with regard to the export of gold, there would be exceedingly little danger of any undue weakening of our reserves.

As it is, opinions seem to differ as to the extent to which we ought to allow our gold to be exported. Opinions, indeed, even among high authorities, are often very vague as to the exact reasons why we collect these huge stores of gold, and what we ought to do with them when we have got them. It is very difficult to dissociate gold from the idea of hoarding, and there have always been people who believe that the best thing to do with gold is to sit upon it. Yet it is generally recognized that one at any rate of the reasons why we collect all this gold is that we may use it in case of need for maintaining the exchanges. It may be, and no doubt is, an extremely difficult matter to hit upon a policy which will combine all merits. We have got to maintain our credit both at home and abroad. Rightly or wrongly, a large gold reserve is viewed throughout the world as the main condition of financial strength and credit. The Bank of England, therefore, must at all times maintain a gold reserve sufficient to satisfy both the population of this country and all foreign countries as to its unshakable strength. It naturally, therefore, regards with some anxiety the possibility of large exports. Yet at the same time it is equally vital to its own credit and traditions and to the position of London as the financial centre of the world, as well as to the existence of our foreign trade, that we should allow our gold to be used to help us to meet our debts. For the Bank of England to sit on its reserve would be the last of our proud and ancient claim that London is the only free gold market of the world.

It must never be forgotten that the whole fabric of British credit, and the whole position of London in the financial world, is built up on the traditional policy of the free gold

market. If that policy is once abandoned—and unfortunately, without making any great effort, the Government have already allowed the situation to get out of hand—our position is fundamentally altered. Not only is our credit shaken, but our difficulties in recapturing after the war our former pre-eminence enormously increased. There is no half-way house between being a free gold market and not being a free gold market. When the American exchange falls to a certain point, then every international banker knows that gold should normally flow from here to New York. If it does not, then he will have reason to suspect that we are frightened of letting it go, and immediately he will become apprehensive as to our credit. He knows that if gold is not allowed to go, there is nothing to stop a continuous fall in the exchange. This general apprehension will increase the difficulties of meeting the situation. It will make more remote the possibility of raising large enough sums in America to relieve the strain. All this has indeed, unfortunately, already been allowed to happen.

There is every reason to suppose that a bolder policy than has been pursued would have been a better one. The country should let gold go when the financial conditions warrant it. It is true that we might lose a good deal of gold. But we can afford it much better than we can afford the shattering of our credit, which the opposite policy involves. The difficulties of insurance, and the risks of carriage, are in themselves a barrier to our losing any very large quantity in a short time. The worst policy of all would be to put such obstacles in the way of gold export as seriously to damage our credit, while at the same time taking no active and determined steps to mobilize all our gold resources in this country, and to insist that France Russia, and even Italy, shall bear their proportion of the exports. We are bearing their financial burden, and it is both just and necessary they should aid us. To maintain the exchanges is as vital to all the Allies as men and munitions. If there were a collapse in the exchanges, neither they nor we could purchase what we require. Thus it is the plain duty of our Government to bring this all-important part prominently before our Allies and to insist for the sake of all that they should share in certain proportions in supplying the gold

needed. If a comprehensive policy to this end were agreed upon, the Allies could well afford to export far more gold than the United States are likely to wish to absorb. It is said, indeed, that America does not want gold. She has £180,000,000 already, and is afraid that additional imports may lead to an undesirable inflation and speculation. All the more reason for sending it. The Americans, like other nations, act from self-interest. The huge orders we are placing in their country are directly to their own advantage. If they do not help us to finance them there will be no alternative for us but to send them gold. If they do not want gold, it is for them to devise other means of rectifying the position.

But it is not enough only to ship gold. We must have a comprehensive plan and at the same time take every other possible measure to fill up the deficit in our national balance sheet. We must sell our securities, produce more in this country, and consume less. As it is, we are unfortunately helping to make the task not easier, but more difficult to accomplish. It is not as if, while ordering great stores of munitions, we were buying less in other directions. We are buying more, very much more in value, since all prices have risen enormously, and more even in quantity. In the official returns of the Board of Trade it is shown that among other items we imported this June *increased quantities* of the following articles of food and drink as compared with June, 1914. The increases were as follows: oranges, over 22,000 tons; cocoa, over 6,000 tons; coffee, over 7,000 tons; tea, nearly 3,000 tons; tobacco, 5,000 tons; pepper, over 1,600 tons; cheese, over 3,000 tons; rice, 28,000 tons; onions, 700,000 bushels, as well as over £3,500,000 more meat. In July we imported nearly £900,000 of tobacco more than last July. Some of these increases are no doubt due to Army supplies, but they are certainly striking figures to any who may think the cry for economy is overdone. There is, it is true, false economy as well as wise. As matters stand, while Germany is somehow or other managing without her usual imports of over £500,000,000 a year, we are importing even more than usual. No selling of securities, no export of gold can keep pace in the end with our present extravagance. It is essential that we should consume less, so that we may have

more to export and less to import. The time is inevitably coming when our artificial prosperity will vanish and we shall be forced by bitter necessity into the path of wisdom. But if we wait until we must before we cut deep into our habits of extravagance, we shall rue it not only during the war, but in the collapse which will come after it is over.

V. Conclusion

Side by side with the armed struggle in the field there is going on another silent, invisible struggle which in the end may be equally decisive—the struggle of exhaustion. The resources of any nation, however rich, engaged in this terrible contest must be taxed to the uttermost. The richer and stronger the nation, the greater the burdens it must shoulder. Germany must support Austria and Turkey; we must support Russia, Italy, and even France. Without our aid in meeting their external obligations the financial power of these countries to make purchases abroad would be seriously crippled already; and it will become still weaker in the future, unless we continue to aid them. The burden is the greatest ever assumed by any community, and our strength, which we have not properly husbanded, is showing signs of overstrain. Yet there is little to show that we appreciate the imperative duty it imposes on every one of us. Abstinence, saving, self-sacrifice in their daily lives, these are not yet resolves which war has evoked in the masses of our people. There are many, it is true, who are already feeling the pinch of higher prices. Yet to vast numbers the war has brought greater affluence and wider opportunities of spending which they have not refused to grasp. We are neither an imaginative nor a saving people, and it is not to be expected that we should realize and carry into action hour by hour in our daily life the irksome, but imperative, practice of economy, just when unexpected means of spending have been placed in our hands. Thus at a time when it is vital that we should consume nothing that is not absolutely necessary, our imports of many articles are bounding up. By some means, if not by voluntary effort, then by compulsion and taxation, this increased consumption must be checked. Undoubtedly the Government must impose heavy taxation

on all imported articles. They must tax the rich heavily, but they must tax the masses of the people, too; for it is in the consumption of the bulk of the population that economies will tell. The rich man must give up his motor-car, and his cigars; but the poor man, too, must be sparing in his tea, coffee, sugar, and tobacco. Of late years luxury and self-indulgence have permeated every class of the nation. Our whole standard of life has been altered. Cannot we manage to go back now even to the standard of ten years ago? Compare the year 1903 with 1913. Within that period, after deduction of re-exports, our imports of tobacco had gone up from 82,000,000 lb. to 162,000,000 lb.; of cocoa and chocolate, from 48,000,000 lb. to 88,000,000 lb.; of tea, from 260,000,000 lb. to 307,000,000 lb.; of sugar, from 1,700,000 tons to 2,200,000 tons, or an increase of 500,000 tons; of wheat, from 4,400,000 tons to 5,200,000 tons. These are a few items, and since 1913 the increases have gone on growing. But the Government must do more than tax. They must show by example that they realize the urgency of economy. They must cut down their own expenditure, and rigidly suppress the appalling waste and extravagance which has been too apparent in many quarters.

The Government have already started a campaign throughout the country to advocate among the people the urgent need of economy. Let them press it on by every means in their power. Let them enlist voluntary help in every district to aid their officials' efforts, whether it be by the formation of local committees or by the assistance of the trade unions, the co-operative societies, the friendly societies, or any other bodies ready to lend a hand.

But, when all is said and done, what is most needed is that all British men and women should realize in their hearts and imaginations that here at home they themselves by their own conduct from hour to hour and day to day, by their abstinence or by their extravagance, by their hard work, or by their slackness, are directly and profoundly helping or hindering their country's cause, and are either consecrating or making of no avail the sacrifices which their husbands, sons, and brothers are making in the bloody fields of Flanders and the

Dardanelles. If a man consumes less, so that we may have less to import, if he works hard, to produce either food or goods, so that we may have more to export, he is making it by so much easier for us to buy munitions both for ourselves and all our Allies, and he is helping to preserve our store of gold and our credit and financial power. If he is wasteful, extravagant, and slack, he is cutting at the tap-root of our strength, and bringing nearer the day when we shall no longer be able to give our Allies the vital help they need, or even perhaps buy for ourselves the munitions and food which are essential to us.

Let us remember that, while so many are fighting in the trenches and can no longer aid in producing what is required, it behoves all of us who are left behind to work doubly hard for the nation's sake. There are many millions of patriotic souls in this country who lament keenly that they can do so little to help those who are offering their lives to their country, but something they can all do. Let them work their best every hour of the day, and let them impose on themselves some real daily act of abstinence. If every man who smoked tobacco in this country were told that, by every one abstaining from smoking for a year, we could afford to buy, in order to aid our cause, £8,000,000 more of guns and shells than we otherwise could, how many would refuse? Yet that is the truth, and it is true not only of tobacco, but of every other luxury we import. If every man, woman, and child saved only 1*s.* a week, it would amount to £120,000,000 a year. Small acts of abstinence practised day by day by the whole population may seem to many mean, useless, and even ridiculous; yet, if our people had the imagination and the strength to carry them out, our whole financial burden would be enormously lightened. It is in the vivid and continuous personal realization of this fact, and in its application to our own lives, that we too often fail. If this war is to be a war of exhaustion, then that people will win which can bring to its aid the greatest energy, abstinence, and endurance.

VI

THE BRITISH EMPIRE'S FINANCIAL TASK

(December, 1915)

Every month which passes brings more and more into prominence the magnitude of the financial burden which the war is placing on the shoulders of Great Britain and the British Empire, and the magnitude, too, of their financial and economic power.

In previous articles an attempt has been made to elucidate the true nature of the financial problem before us, and what efforts and sacrifices it demands from the whole people. The subject is so all-important that no apology is needed for returning to it. The strain to which the United Kingdom is being, and will be, subjected is clearly evidenced by our vast expenditure. We have been told officially that every one must be ready to give the Government through taxation or loan at least half his income, and we have been warned that our financial strength is to be strained to the uttermost. It is not the intention of this article to discuss in detail the financial measures and expedients by which the Government will have to meet the Country's requirements. Its aim is rather to examine the financial and economic problem as it concerns the nation as a whole, to investigate what is really happening beneath all this machinery of loans and taxation, and, finally, to make clear what part can and should be played not only by the citizens of the United Kingdom, but also by the Governments and citizens of every other part of the Empire, if we are to carry through the war to a successful conclusion.

I. The Financial Position

Mr. McKenna has recently estimated that our expenditure during this financial year will be about £1,600,000,000. Of

this about £300,000,000 will be covered by taxation, leaving £1,300,000,000 to be covered by loan. In last July a loan of £600,000,000 was raised. To cover our expenditure up to the end of next March loans in some form or other amounting to not less than another £600,000,000 will be required. By March next our daily expenditure will probably be well over £5,000,000 a day, or at the rate of not much less than £2,000,000,000 a year, a sum practically equal to the nation's whole income. Our revenue for next year is estimated at about £400,000,000. In other words, if the war lasts for another year beyond March next, we shall have to find an additional £1,600,000,000 by loan. Thus our financial burden, vast as it is now, is growing rapidly. Our present expenditure is enormously increased by the necessity we are under of lending very large sums to our Allies. These, we are told, will amount this financial year to about £400,000,000. We may hope in time to recover these huge debts, but for the time being they are just as much expenditure which we must meet as anything else. How important and essential is the financial help we give to our Allies is proved by the calculation that our loans are sufficient to pay for the equipment and maintenance in the field of 3,000,000 men.

We have raised already since the beginning of the war, in one way and another, by loan, or Exchequer or Treasury Bills, something between £1,100,000,000 and £1,200,000,000. We have got to go on raising money now at still greater speed. Somehow or other the Government must have the money it requires. If it cannot get it by normal methods it must get it how it can, even if it were eventually driven to forced loans, or inflation of currency. As long as the people of a country are prepared to go on fighting, continue to believe in their own financial stability as a state, and can produce or buy what is necessary for themselves and their soldiers, they need not be absolutely prevented by lack of "money." If the goods are there, and the Government's IOU's are taken, the "money" can be created; the printing-press can print more currency, and State loan banks can be created, as in Germany, to lend money on all kinds of security. But necessary as these measures may be, let no one suppose they are not evil. They lead to

great inflation and to a continued rise in prices. They may for the time being deceive the country by providing all the appearances of prosperity. Money will be plentiful; high prices will yield great profits; the huge Government expenditure will lead to a wide redistribution of wealth. Yet meanwhile the appearance of greater wealth will be accompanied in reality by its increasing shrinking. The deposits of the banks may increase, but the real wealth, which they represent, will be less. High prices may to many bring great profits; to many more they will bring great suffering. The inflation of credit may encourage and allow for a time of increased consumption, but, since it does not add one iota to production, it will only add to the increasing difficulties in the way of supply meeting demand and of the country paying for its foreign purchases. The financial measures, whether by loan or taxation, which the Government may take to supply its needs in the way of money, are of the first importance for the maintenance of our credit and for the conduct of the war. But with these details this article is not concerned. It is to be supposed that somehow or other the Government will be able to obtain *at home* all the money it requires, to buy such goods as can be produced *at home*.

If Austria-Hungary can find the money to keep armies of millions in the field, it is to be supposed that we can. Our real problem is a different one. It is whether we—i.e., the nation as a whole, Government and people alike—can continue to buy *from abroad* all the goods, food, munitions, etc., which we and our Allies must have. And here it is no longer so much a question of financial expedients. We may raise twenty war loans in this country; we may tax ourselves twenty times as much; but that will not provide us with a single dollar to pay the Americans what we owe them. Our own internal currency, our own Government's IOU's are good enough for us, but they are no good to America. It is no good our Government offering Americans a cheque on the Bank of England. They want money which is current in their country, not our money. Our Government may, it is true, persuade them, as indeed it has just done, to lend it some of their money, which it can then use for payments due over there. But apart from

what it can borrow, it has no other means to pay beyond such as are available to the ordinary British citizen. It can find money to pay abroad only out of the proceeds of our exports, or by the sale of gold, or by the sale of securities, or for money due to us for services rendered, such as freight. Since, therefore, we are buying so enormously from abroad, it is worth while to consider by what means we propose to pay. For if those means were to fail us and we could not persuade our foreign creditors to lend, no financial expedients, such as the Government may use to provide itself with money in its own country, will help us.

We should then have to go without the goods we want, or in any case cut down our requirements drastically. That is no figure of speech. We are not lending £400,000,000 a year to our Allies because we like doing it. We are doing it because they can no longer buy what they want for themselves. Russia can find the " money " she wants in her own country, but she cannot export the goods to pay for what she wants from foreign countries, nor will they lend her their goods on credit. Therefore she must either do without what is essential for her, or we must help her. This assistance in purchasing from abroad, which we grant so lavishly to our Allies, is vital for them. Let us examine our capacity to continue it.

II. The Economic Position

(a) *The National Income and Expenditure of the United Kingdom*

It is simpler for a clear understanding of the burden which the war entails on Great Britain, and of the manner in which alone it can be met, to ignore for the time being the financial elements of the problem, and to fix our minds rather on things : on the actual processes of production and consumption lying beneath all that intricate financial machinery which is apt to obscure realities.

Neither in peace nor in war does a nation live on " money." Its gold and silver coins have, it is true, an intrinsic value of their own, but neither they nor its bank-notes, nor its currency notes, nor its bank deposits are its real wealth. Its real wealth is something quite different. It consists of all those existing

things which the efforts and sacrifices of past generations, and of this generation too, have produced, and are from day to day producing. It is from this mass of wealth, which either has been produced in the past or is day by day being produced—i.e., from its capital and income—that a nation's needs, whether in peace or war, can alone be met. There is only one other source, and that a temporary and unstable one—namely, borrowing from other nations, or in other words the sale by foreign nations of their goods for the time being on credit. No inflation of credit, no increase of currency, no financial manipulation will of itself produce a single additional grain of wheat or a single additional cartridge.

It is worth while to return again to the examination—already made in a previous article—of the exact nature of a nation's capital and income, since important consequences, which are not generally understood, bearing on the conduct of every man and woman in war time, flow therefrom.

A nation's capital may be defined as the whole mass of its accumulated wealth consisting of:

(*a*) Fixed assets such as land, mines, buildings, machinery, railways, roads, canals, etc.

(*b*) Live stock, stocks of raw materials, and manufactured articles of every kind.

(*c*) Gold and silver coins, and bullion.

(*d*) Debts owing by foreign nations, and property owned in foreign countries—(e.g., through bond or share holdings in foreign companies).

(*e*) The intangible but all-important capital represented by the inherited and acquired skill, energy, organization, discipline, and productive capacity of the people.

A nation's income, which is larger or smaller according to the amount and quality of its capital, consists roughly of:

(*a*) Its current output or production of wealth in the form of usable or suitable articles of any kind, or service exchangeable therefor.

(*b*) Its earnings from other nations for services rendered—e.g., debts due to Great Britain for freight, for banking commissions, etc.

(*c*) Its revenue derived from foreign investments.

It should be noted that in reality the income under (*b*) and (*c*) does not come to it in the form of money. In reality it enables the creditor nation to obtain goods from foreign countries to the extent of those earnings and that revenue without having to export goods to pay for them. From the national point of view, therefore, they represent so much additional wealth in the form of goods which the nation can consume.

It is interesting to compare the figures usually given by statisticians for the value of our capital and income as compared with Germany's, and for the respective expenditure of the two nations, a comparison which gives some remarkable results. Statistical figures of this nature can only be very approximately true, and other difficulties arise, in comparing results as between nations, whose standards of life and ways of living are very different. Nevertheless, they form an adequate ground for broad comparisons. Dr. Helfferich, the present German Finance Minister, placed Germany's capital wealth in 1913 at something under £16,000,000,000. He estimated the United Kingdom's capital wealth at only £12,000,000,000. But British statisticians make a considerably higher valuation, and usually give for the United Kingdom the same figure as he gives for Germany—namely, £16,000,000,000. Since, then, the populations are respectively 68,000,000 and 47,000,000, our capital wealth per head is considerably greater, a result due no doubt in the main to our much greater holdings of foreign and Colonial securities, which are usually said to equal about £4,000,000,000, though it is probable that they have of recent years largely decreased in value. The comparative figures for income yield still more striking results. For Germany we will take Dr. Helfferich's figures, for the United Kingdom the figures of the Census of Production of 1907, though since that date our wealth must undoubtedly have increased.

	England. £	Germany. £
Goods and services produced and received, about	2,150,000,000	1,960,000,000
Goods and services consumed. .	1,800,000,000	1,560,000,000
Surplus wealth	350,000,000	400,000,000

These figures show that 47,000,000 British have an income

of £2,150,000,000, or just over £46 per head, whereas 68,000,000 Germans have an income of £1,960,000,000, or under £29 per head. They further show that, while our expenditure per head is over £38, Germany's is £23. According to this calculation each man, woman, and child in the United Kingdom spends £15 a year per head more than each German man, woman, and child, and if, therefore, we were to cut down our expenditure to theirs, we should save £720,000,000 per annum. The German economy in expenditure is especially striking owing to the fact that the cost of living is generally considered to be higher in Germany than in England. It is not, however, intended to argue that the comparison is actually a fair one, or that so huge a saving is reasonably to be expected from us. Indeed, owing to the different standards of the two nations, no accurate mathematical comparison is possible. If we were to cut down our expenditure so drastically, we might cut down much of our income with it. The figures quoted are, however, sufficient to show that there is a great deal of room for economy in our way of living. They are especially remarkable if one remembers that the German standard must by now have been cut down again far below £23 per head, probably, indeed, at least one-third lower, while ours has hardly been reduced at all, if, indeed, it has not increased.

It is vital to grasp how all-important is a nation's annual production of wealth. Whether in peace or war what it lives on is what it produces from day to day. The figures quoted above show that the wealth—i.e., the materials, goods and services—produced each year in this country are not much less than one-sixth of the total capital wealth of the country, resulting from the efforts of all past generations. It is true that the great bulk of this annual production is immediately consumed, only something under one-fifth being added to the capital stock. Yet nothing could show more clearly that a nation's true wealth lies in the harmonious employment of the energy, skill, productive capacity, and thrift of its citizens. A nation's production of wealth is not something fixed. It is capable of being indefinitely expanded by the application of increased capital—i.e., by the savings of the nation transformed into additional or improved plant, into labour-saving devices,

into increased motive horse-power per man, and, on the other hand, by the greater efficiency of labour, superior management and the greater co-ordination of the efforts of labour and capital. But, if owing to extravagance and failure to save the necessary capital, owing to inefficiency of labour, restriction of output, or bad organization, owing to continued friction between capital and labour, a nation's income falls far below what it might be, then all classes will suffer and the nation as a whole fall behind its competitors.

In normal times, as will have been seen, nations like England and Germany have an income a good deal larger than their expenditure. They add yearly quite a large amount to their capital wealth. The more they save the more easily do they increase each year their surplus wealth. And this surplus wealth is then applied in the direction of improving the national plant as defined above, adding to and bettering the machinery of production and transport, or else in lending capital to foreign countries. Nevertheless, this annual surplus income, out of which improved conditions of living are built up, is never so large as it might be. Certainly in England it might be far larger. Its size depends (1) on the productive energy of the nation and on every man helping to produce as much as possible, (2) on the nation consuming only that portion of the product which is necessary for its true needs, and on every citizen wasting on useless purposes as little as possible. It has already been pointed out how serious from the point of view of production is the policy of restriction of output, fatal, indeed, both morally and economically. The maldistribution of the national income, which imbues the working classes with a sense of injury and injustice and leads to so much dangerous friction between capital and labour, in turn checks production and so injures the whole nation. With a proper distribution of wealth the greatest possible production must be of equal advantage to all classes. The problem of the better distribution of the national income is, therefore, one for which some solution, or at least amelioration, is vitally required.

On the side of consumption the growing wealth of a nation and its bad distribution tends to great waste. The growth of luxury diverts the nation's productive powers into supplying

unproductive articles. All classes become wasteful in food, drink, clothing, and household economy generally. What this means may be gathered from Sir Robert Giffen's estimate, made some years ago, that 34 per cent of the national expenditure is on food and drink, 13 per cent on dress, and 16 per cent in "house" expenditure, including rent, furniture, light, etc. The rich become wasteful in all their pleasures, motoring, dress, servants, etc. They demand that labour shall be uselessly employed in providing for all their unnecessary wants, and the less rich follow suit as best they can. Take one or two instances of wasteful consumption. Our drink bill in 1913 was over £166,000,000. All that money could have been productively employed. As it was, it went to employ labour, capital and ability on the growth of barley and hops, the working of breweries and distilleries, and on the management of countless public-houses. In the end the product of all this great labour and effort had gone down the throats of the people, generally to their great detriment, and nothing remained. Had it been diverted for the betterment of our productive industries—suppose, for instance, that it had been employed in providing better motive power for our industries or in rebuilding our canals or in better clothing, housing, or education of the poorer classes—our wealth would have been much greater. Again, when a rich man employs much labour and capital in his unproductive pleasures, in keeping, for instance, too large a number of men-servants or gardeners for pleasure gardens, or when his wife employs many dressmakers, they are diverting the nation's labour and capital from productive to unproductive wealth. Nor is it only the rich who err, though in their case the error is the more glaring and the less pardonable. The poorer classes in this country are perhaps less thrifty than their fellows in any great civilized country except the United States. Unfortunately there are too many millions for whom saving is practically an impossibility. But, even where it is possible, it is a comparatively rare virtue, as the profits of public-houses, cinemas, theatres, and race-course "bookies" show. Many social troubles would be remedied if both rich and poor learnt more of the true art of economical living.

(*b*) *The Effect of War on the National Income and Expenditure*

The effect of modern war on a nation's income is profound. It changes the amount, and still more the character, both of the production and the consumption. It is not possible to calculate accurately the extent of the changes. The unknown factors are too many. But it is possible to show generally the influences at work and to form some measure of their effects.

The national income and expenditure of the United Kingdom were estimated above at about £2,150,000,000 and £1,800,000,000 respectively. The income has been affected in the first place by the withdrawal, most of them from productive occupations, of about 3,000,000 soldiers and sailors between the ages of 18 and 44.

Now, since the "occupied males" between those ages in England and Wales amounted in 1911 to 7,200,000, it is clear, after adding the equivalent figure for Scotland and Ireland, that well over one-third of the most vigorous "occupied males" have gone. On the other hand, the gap has been partly filled at any rate by unemployed men, by women and boys, and by harder work and more overtime generally. It is possible, indeed, that the loss of productive power has not exceeded 10 per cent. Let us suppose that the nation's productive income, excluding therefrom soldiers' wages as not being in this sense productive, and excluding rises in prices, which affect income and expenditure equally, has fallen to £2,000,000,000, or by 7½ per cent.

In the second place, however, that product has changed largely in character. It has changed owing to the enormous demand by ourselves and our Allies for munitions of war not used before. Let us assume for a moment that the consumption of the nation, including the non-munition consumption of our soldiers and sailors, is as usual and amounts to £1,800,000,000. Our income being £2,000,000,000, there is a surplus of only £200,000,000 left to meet all the munitions required by ourselves and all our loans to our Allies, which will be taken in the form of goods from us or other nations. It is impossible to say how much out of our Government expenditure of £1,600,000,000 is in respect of these two items. It may well be £1,000,000,000. If so, there will be a shortage of £800,000,000,

which must be met either by saving, or out of capital, or by borrowing. Let it be remembered this is not money we shall be short of, but actual goods.

Let us give the calculation in another way, giving figures for actual goods produced only, and omitting altogether the value of productive services, such as the services of Government servants, railway officials, hotel keepers, etc.

The Census of Production for 1907 gives the following figures for the goods which we actually produced or obtained by exchange, or lent abroad by way of investment:

	£
1. Goods used for personal consumption .	1,410,000,000
2. Goods available for capital purposes:	
(*a*) Maintenance of existing plant . .	180,000,000
(*b*) Investment at home	190,000,000
3. Goods used to maintain or increase stocks of consumable goods	65,000,000
4. Goods exported as means of payment for loans to foreigners	100,000,000
Total	£1,945,000,000

This figure of £1,945,000,000 represented in 1907 not only what we produced for our own use, but what we obtained from abroad, either in exchange for goods exported or in return for money due for interest on investments, freight, etc., together with an additional £100,000,000 of goods which we had over and available for lending abroad. Of the above items it will be seen that Item 2 (*a*) and in part Item 3 were required purely for maintaining our plant and working capital. In other words, say, £200,000,000 must properly be deducted to arrive at what goods are available for consumption without living on our capital.

This leaves £1,745,000,000. Now if we assume, as before, that our production of goods is less by 7½ per cent, we get a resulting figure of £1,615,000,000. On the assumption that we still consume for personal use £1,410,000,000, and yet must have £1,000,000,000 of munitions for ourselves and goods and munitions for our Allies, we again arrive at a shortage of actual goods of about £800,000,000. This actual shortage can only be covered either by a reduction in the goods consumed

for our personal use, or by living on our capital, or we must beg, borrow, or steal from our neighbours.

Mention has more than once been made of our living on our capital. To what extent can we meet our actual shortage of goods in that way? If reference is made to the definition of national capital earlier in this article, it will be seen that much of it is obviously unusable. We cannot actually live on our land, railways, machinery, etc.; we can, it is true, cease to keep them up to standard, and spend nothing or much less on the upkeep of our national plant. We can, too, let our stocks of materials and live stock diminish. The figures just quoted from the Census of Production show that we might find between £200,000,000 and £240,000,000 in this way, that being the actual amount we spend yearly on upkeep. But, unless our plant is to go to rack and ruin, we cannot long continue such a spendthrift policy. Failing this we can only live on our capital to the extent that we sell it to foreign countries. We have, it is calculated, £4,000,000,000 of investments outside of England, though their value must be less now. But only quite a small fraction can be sold. We can hardly sell much of our own fixed capital in our own country, and the last thing we want to sell is our mercantile marine.

We can, it is true, sell a good part of our gold. But, when we come to the end of that and of our securities, we have no other resource but to borrow, unless we can by efforts in production and saving live more within our means.

(c) *Our Foreign Debts*

Owing to the fact that, as has just been shown, our needs and those of our Allies so far exceed the balance of our production over our consumption, we are buying at an enormously increased rate from foreign countries to fill the gap. It is impossible to get exact figures on this score, since the amount of Government purchases is unknown. But some estimate can be made. According to the official figures our imports are now exceeding our exports at the rate of nearly £400,000,000 a year. But this is exclusive of Government imports. Let us suppose these are at the rate of £200,000,000 a year, though, since no figures are published, this must be simply an

estimate. Against this total of £600,000,000 have to be set our earnings on account of freight, banking commissions, and interest on investments abroad. The two latter are certainly smaller than they were. Freights are, on the other hand, enormously higher, but a very large proportion of our mercantile marine has been taken by the Navy, and it is a question whether the amount of goods we are carrying for other nations is not very much smaller. Our earnings from all these sources are usually stated at about £350,000,000 a year. We shall be optimistic if we place them now at £400,000,000. That still leaves a debit balance of £200,000,000, to which must be added loans to our Allies at the rate of £400,000,000 a year, making a total balance against us of £600,000,000. This great sum can only be met out of capital, i.e., by selling our securities or our gold. It is not worth while making any estimate of the extent to which we can meet it in that way. In so short a time as one year we certainly cannot meet it all. The only alternative is to borrow, or in the alternative so to increase our home production and at the same time reduce our scale of living so substantially as to reduce our imports.

It is instructive to compare our position in this subject with that of Germany. Germany has been faced with all our difficulties. With so many men fighting and so huge a production of munitions, her national income available for consumption by the civil population must have been enormously reduced. Unlike us, she cannot make up the shortage by importing from abroad. She can only make both ends meet by her own efforts, by the wholesale employment of women, boys, and old men, by the extreme development of her productive energies, by living on capital in the sense of spending not a penny more than is absolutely necessary on the upkeep of roads, railways, houses, machinery, and so forth, by living on her stocks of materials and live stock, and finally by the utmost economy in consumption on the part of her whole people. Even so, it is clear that there must be a very great shortage generally, since prices are enormously high. The economic strain and suffering in Germany are much greater than they are yet with us. But she reaps this advantage that, unlike us, she is not on the way to pile up a great external debt which must later be redeemed.

How long we can continue to live at our present pace depends on the extent to which foreign countries and especially the United States and in addition also the British Dominions are ready and able, to sell the goods we want from them on credit. In normal times economic forces would of themselves very quickly prevent a nation from living beyond its means, as we are now living. Economic forces are always pulling a nation towards an equilibrium between its buying and selling. So great a balance of trade against us would mean so great a fall in the exchanges that the cost of importing goods would become prohibitive, and we should be driven to mend our ways. But when Governments buy regardless of cost, economic forces cease to act. Moreover, we are attempting by abnormal means, by large shipments of gold, by the sale of securities, and by loans such as the recent £100,000,000 loan in New York, to maintain artificially the exchanges. This is a sound and indeed a necessary policy, but it has this great disadvantage, that the ordinary importer is not discouraged from importing by a falling exchange and the ordinary consumer from consuming by quickly rising prices. Moreover, our imports are now so great that the Anglo-French loan in the United States has by no means solved the question of the exchanges, and the Government will be bound very seriously to consider whether imports on the present huge scale can be permanently combined with the free export of gold and the attempt to maintain the exchanges at something like their normal figure.

Meanwhile the growing shortage of goods, the increasing inflation from which we can hardly escape, is bound to lead to higher and higher prices. The more goods each of us consumes, the more costly and difficult will life become for our poorer brethren, and the greater the burden of imports on the country. The figures in the last Board of Trade returns are eloquent of this fact. For the nine months ending September, 1915, we imported £285,000,000 of food, drink, and tobacco, as against £210,000,000 for the same period in 1913, the last normal period with which comparison can be made. For the same two periods we imported 17,000,000 cwts. less grain and flour in 1915 than in 1913, and yet they cost us £20,000,000

more. We imported 2,300,000 cwts. less meat, yet meat cost us £26,000,000 more.

III. The Capital and Income of the British Empire

The discussion hitherto has been confined to the financial and economic position of the United Kingdom. But it may be asked: What about the resources of the British Empire as a whole? It is the British Empire, not the United Kingdom only, which is at war. There is no part of the British Empire which is not vitally concerned in the struggle. Are not the whole resources of the Empire available? And are they not much greater than the resources of the United Kingdom only?

In 1903 Sir Robert Giffen made the following estimate:

	Capital.	Income.
Canada	£1,350,000,000	£270,000,000
Australasia	1,150,000,000	210,000,000
India	3,000,000,000	600,000,000
South Africa	600,000,000	100,000,000
Remainder of Empire	1,200,000,000	200,000,000
Total	£7,300,000,000	£1,380,000,000

Here, indeed, is a great addition to the wealth of the United Kingdom alone, and since 1903 the wealth of the rest of the British Empire has been largely increased. Sir Robert Giffen then estimated the income per head of Canada and Australasia at £48, as against £42 for the United Kingdom. Since then the latter figure has increased to £46 and it is hardly open to doubt that the figure for Canada and Australasia has increased in proportion. Let us take it, however, at £50 per head. If the populations of Canada and Australasia are taken at 8,000,000 and 6,000,000 respectively, their annual incomes would then be £400,000,000 and £300,000,000 respectively. If Giffen is right in assuming that for a new country the income could be estimated at about one-fifth of the capital, then the capital of Australasia and Canada would be £2,000,000,000 and £1,500,000,000 respectively. These calculations are fairly accurately borne out by the relative size of the banking deposits in each country, the deposits in Canadian banks being over £200,000,000 and in Australia (apart from New Zealand)

about £170,000,000, as compared with British deposits of roughly £1,000,000,000. It is interesting to note that the figures given above for Canada—namely, capital £2,000,000,000, income £400,000,000—tally almost exactly with the figures for the United Kingdom in 1816 at the end of the Napoleonic wars, when the national debt stood at over £800,000,000. If one estimates that the United Kingdom is now raising loans at the rate of £1,400,000,000 a year, then Canada and Australia, if they were incurring indebtment at the same rate would, on the basis of their income as compared with that of the United Kingdom, be raising about £250,000,000 and £190,000,000 annually, and on the basis of their capital about £170,000,000 and £130,000,000 annually. If population were taken as a basis, the figures would come out approximately the same as on the basis of income. What has been the increase in the wealth of South Africa, of India, and of the other dependencies of the Empire since 1903 it is impossible to say, but that it has increased greatly there can be no doubt. If it could be assumed to have increased in the same proportion as that of Canada and Australia, then the capital of the Empire outside the United Kingdom would be over £10,000,000,000, and the income over £2,000,000,000, the income thus being about equal to that of the United Kingdom. It is no doubt, however, a good deal too sanguine to suppose that India's wealth has for instance increased in the same ratio as Canada's. Yet the figures quoted are sufficient to show the enormous economic strength of the Empire as a whole.

There is no other state in the world which approaches anywhere near this economic strength with the exception of the United States. If all this great wealth and all these resources lay within a ring fence and could be as readily and as directly and as ruthlessly employed on the object of the war as are being and will be those of the United Kingdom, and could be developed and utilized by one Government within one single financial system and with a single aim to the war, in the manner that the resources of the United States would for instance be employed in similar circumstances, the addition to our economic strength would be enormous. But this cannot in the nature of things be so. Each part of the Empire is under a different Government;

each possesses a separate financial system. Its great wealth is, so to speak, stored in separate reservoirs—a British, a Canadian, an Australian, an Indian reservoir. The British Government can by its taxation and its loans only pump the money and goods it requires out of its own reservoir; the Canadian and Australian Governments only from theirs. If the British reservoir is running low, then it is only the other Governments which can give it or lend it more supplies. It is worth while to be clear as to the consequences of this position. The food products, the raw materials, the munitions of war which England receives from the different parts of the Empire are invaluable to her, but so long as she has to pay for them in cash she is no better off financially than if they came from neutrals. It makes no difference to the British Treasury whether it has to pay $15 for a shell to an American or a Canadian manufacturer, or to an English miller whether he pays $1 a bushel for wheat to Australia or the Argentine. The British Treasury and the English miller no doubt prefer to buy from the Canadian manufacturer and the Australian farmer, so as to keep the money in the Empire. But to the British taxpayer and the British consumer the result is identical. In truth, the great wealth of the British Dominions over the seas, while potentially of enormous value, is of use in the present war only in so far as it is employed on its objects. And it can only be so employed to the extent that the different parts of the Empire either meet out of their own resources their own cost of the war, or lend money out of those resources to the British Government, or in other words sell them their exports on credit, just as the United States by lending £100,000,000 is selling to France and England its goods to that extent on credit.

It is not suggested that it lies within either the duty or capacity of, say, Australia or Canada to raise by loan or taxation any sum, proportionate so far as wealth goes, to that which is being raised in the United Kingdom. A new country in the course of rapid development, with less abundance of liquid wealth and with no foreign investments, is in a different category from an old country like England. Yet the time may come, and quickly, when Great Britain may have to ask the larger Dominions whether there is any method—in addition to the great

assistance in men already given—whereby they can contribute financially towards ensuring victory. The British people are taking on very heavy burdens. They have already been told officially that every man must be ready to give up half his income to the service of the State. The assistance which can be given financially from the other parts of the Empire would be of the utmost service. It so happens, too, that the assistance which the Dominions might give would be of a kind which would be the most valuable of all. If the conclusions of this article are right, then the great difficulty of England will be to find the means to pay for her purchases of food, raw materials, and munitions from oversea. What greater help could the Dominions give than to advance her for the time being the money wherewith to buy the food and other materials which she can get from them ? It is a tradition, difficult to forget, that England is always the lender and the Dominions always the borrowers. War changes many things. England can no longer lend. Are not the Dominions now in a position to finance their own expenditure, war and otherwise ? Australia is indeed raising an internal loan of £20,000,000 for her own purposes ; Canada is going to raise an internal loan for the same end. But are they not in a position to do a still greater service to the Empire by raising money internally for the purpose of making advances to the British Government ?

There should be no difficulty in the financial measures required. Take, for instance, the case of Canada. Owing to the great economies in expenditure which she has made, and to her fine harvest, it is probable that Canada, instead of the usual heavy balance of trade against her, will, if her people continue to be economical, have a favourable balance of even up to \$200,000,000. Of this \$125,000,000 is required for interest on her external debt. But it is quite possible that she could raise by loan in New York an amount at least equal to the latter sum, in which case she would have her whole surplus available to lend to Great Britain. She will in so doing benefit herself as well. She will be merely forgoing the immediate enjoyment of her profits and building up for herself a reserve abroad which will be very useful to her after the war. It would, of course, serve the same purpose if she were to use her surplus to pay off any

indebtedness to England shortly falling due. The more the Dominions were able to lend, the greater naturally would be England's purchases from them of food, munitions, and raw materials—in preference to neutrals. They would thus reap the immediate benefit of their loans. In turn, in order to find the money, they would need to practise the same saving and abstinence from new expenditure as is now being enforced on the British people. A further and indirect result might be a very large and permanent development of inter-imperial trade.

It is not open to question that all parts of the British Empire are equally determined on any sacrifice to win the war. The British Government in its position of trusteeship for India and the other dependencies is not in a position to place a great burden of debt on them. Nor is South Africa, in her peculiar position, able to do more than meet her own requirements. It remains, however, for consideration between the British Government and the larger Dominions whether some financial plan, such as has been briefly sketched here, would not be practicable, of equal benefit to all parties, and of immeasurable assistance to the Empire.

IV. Some Conclusions

The wealth of the British Empire is so great that it seems hardly open to doubt that it will outlast that of its enemies. The issue lies largely in our hands and those of our kinsmen overseas. Our weakness is that Great Britain is obliged to purchase so large a proportion of her own supplies and those of her Allies from overseas, and is running short of the normal means of payment. It is no mere chimera to suppose that England may at the present rate come to the end of those means on the scale she is requiring them at present. She alone indeed of all the belligerents is in a position still to continue her purchases freely to meet her needs. It is wise, therefore, not to shut our eyes to the possibilities of the future. Germany has been forced to live on herself. Whether she can continue to do so indefinitely remains to be seen. We, on the other hand, have based our whole war policy on our ability to maintain our supplies from abroad. Fortunately there is no reason to assume

that we shall not always maintain our power to buy a great deal abroad. Our ability to repay in the long run is undoubted, and it is therefore very greatly to the interest of the countries chiefly concerned to sell us their goods even on credit. If, however, these supplies were to be largely cut off, we should have to alter our policy, and try to make ourselves self-sufficient, or nearly so. That the Empire could do so if every part were ready to make the sacrifices required there is little doubt. But it would involve, on the part of the people of Great Britain particularly, efforts and sacrifices far greater even than any hitherto made.

It is therefore a matter of the first importance that we should preserve our credit and our buying power. To that end we must devote our whole energies to increased production and simultaneously to the strictest economy in consumption. And not only we in Great Britain, but the citizens of the Dominions too, so that they may, by giving their assistance not only in men, but in money, lend their decisive aid to help their brothers and ours in the trenches, and to carry the Empire victoriously through this great crisis.

VII

THE FINANCIAL AND ECONOMIC FUTURE

(December, 1918)

I

Perhaps the greatest of all internal problems after the war is that of providing ample employment at good wages for our people, or regarded from another angle, of securing prosperity to trade and industry. Much will depend on the method of the settlement of certain serious questions between Capital and Labour. But they are only part of a far larger whole. There are other and even more fundamental problems of a financial and economic character, upon the successful solution of which rests the whole future of industry, trade and employment. The proper handling of them is so vital, and yet is likely to run counter to so many vague beliefs and ideas in the minds of all those unacquainted with the conditions of our economic and financial stability, that it is worth while to make some attempt in a broad and even crude way to state them simply.

There are many people who believe that we have during the war stumbled upon some new and easier way of living and earning our livelihood which renders many of the old doctrines of political economy obsolete. Notwithstanding the vast wastage of war, they see apparent prosperity, full employment and high wages. If these things are done in the dry leaf, what may be done in the green? Should there, they ask, be any difficulty at all in peace time in at least equalling our prosperity in war? It is true that we have learnt many lessons in war. We have learnt that we were at the least rich enough then to have devoted much more money than we did to education, health and other means of raising the standard of living. We

have learnt that vast numbers of our people were earning wages barely sufficient to maintain even a low standard of health, far less physical well-being and comfort. We have learnt that the true wealth of a nation consists in a healthy, strong population, and in the utilization of its material resources to that end. But unfortunately—as we shall find—we have discovered no new Aladdin's lamp, no new short cut to prosperity. Wages and profits depend as of yore on hard work, saving, efficient management, co-operation between Capital and Labour, and up-to-date plant. There is no inexhaustible fund of riches into which the State can dip its hands, and which it can distribute gratis to its citizens. Our wealth is what we produce and what we save. If we have wasted capital in war, we shall have to make it good. If our production is impeded and saving gives way to extravagance, profits and enterprise will decline and wages and employment with them.

We must not be misled by the fallacious appearances of war. We have been enjoying the temporary prosperity of a spendthrift, speeding towards bankruptcy. We have been living easy, because we have been living on our capital. We have imported from abroad hundreds of millions of pounds' worth of materials more than we can afford : the war demands of the Government have created, without regard to cost, an unlimited purchasing power, which has been rendered effective by the raising of vast loans. Many of us—all who live on fixed salaries or incomes—are getting daily poorer, but in the main the community has been enjoying great apparent prosperity. It is the custom to argue that internal Government loans are no burden, since they represent merely money owed by one section of the community to another. But, even apart from their evil effects on credit, prices and our whole financial structure, this argument is fallacious. If, for instance, our war loans were so increased that to meet the interest bill the income tax had to be raised to 20*s.* in the £, the enterprise and initiative of all who were not holders of War Loan would be effectively sapped. Long before so extreme a point is reached, the heavy taxation involved acts as a serious hindrance to enterprise. Moreover, it is not desirable that the nation should be divided into a rentier class living on the interest of its

war debt on the one hand and the remainder of the population paying tribute to it on the other. For this reason alone and still more for reasons of a more strictly financial character mentioned hereafter, it is desirable that the State should as soon as possible bring an end to its borrowings, both internal and external. We shall then find that the hard lessons of the past apply also to our own days and that nations as well as individuals can make good only by work and saving.

II

The war has naturally brought with it very great economic and financial changes. In general it may be said that the last four years show all the characteristics which in peace time, though in a less extravagant degree, accompany a period of great expansion, rapidly rising prices, and increased purchasing power. Industry has been at full blast; there has been ample work for all, and wages have rapidly increased. Unfortunately, too, conditions have been ideal for the "profiteer," large and small. There has been as a result an appearance of very great prosperity. But, as already stated, it is not generally recognized at what cost to our economic strength this superficial prosperity has been obtained. It would, indeed, be an extraordinary paradox if the gigantic waste of material which every day of this great war has caused had led in reality to increased wealth.

The main outward accompaniments of war conditions are, indeed, clear to every one. Prices have risen since 1914 by over 100 per cent. As a correspondent in *The New Statesman* recently put it, "The John Bradbury note worth £1 when first issued is to-day when spent on food worth 8*s*. 9*d*." This rise in prices has been stimulated by the enormous Government war borrowings and spendings. With each rise greater supplies of currency and credit are needed; these, in their turn, by increasing general purchasing power, raise prices. Credit, currency and prices have had a mutually stimulating effect. Many other factors, such as freights, the unlimited demands of war and scarcity of materials add their influence. Not only are prices over 100 per cent higher, but owing to Government

restrictions, Government subsidies, and other causes they are unstable. If trade were entirely unhampered and subsidies withdrawn, some prices—e.g., of bread—would rise. In general, prices would probably fall. A similar condition of very high prices exists in a greater or less degree in all belligerent countries and, indeed, in all neutral countries as well. But until more normal conditions return, it is impossible to see whether our level of prices is higher than those ruling in other countries. High prices are especially burdensome to a great importing country such as Great Britain. The larger the country's imports in excess of its exports the greater the strain thrown upon it by a rise in prices.

In many instances wages have increased as much if not more than prices ; in many others, not as much. In other instances, especially for comparatively unskilled munition work, wages far too high to be economically possible for similar classes of work in peace time are being paid. The normal standard rates of wages have disappeared and wages are as unstable as prices.

Another obvious and striking change has been the enormous increase both of currency and of banking deposits. In their report, recently published, the Committee on Currency and Foreign Exchanges estimate that legal tender in the United Kingdom has increased from £179,000,000 at the beginning of the war to £382,000,000 now, and banking deposits (excluding those of the Bank of England) from £1,070,000,000 to £1,742,000,000.

These figures would in normal peace times be regarded as evidence of a great increase in the wealth of the nation. But it is clear a similar deduction now would be misleading. Notwithstanding all the exceptional hard work and saving of the nation, the vast waste of war has undoubtedly largely reduced our capital wealth. We have let our national plant run down ; our railways, roads, houses, and so forth have fallen into disrepair. We have, indeed, very largely suspended that general work of renewal and repair which absorbs perhaps one-tenth of the country's economic energy every year. We have, moreover, disposed of a vast mass of wealth in the form of our foreign securities. Mr. Bonar Law has recently told us that

we have sold or pledged to the United States practically the whole of our American Railway and Industrial investments, "the finest of our Foreign securities," amounting to about £600,000,000. But this is not nearly all. We have in addition incurred an enormous uncovered indebtedness abroad, rendered necessary by our purchases on our own and our Allies' behalf. Ever since the beginning of the war our imports have been abnormally high and our exports abnormally low; at this moment our imports, according to official figures, are at the rate of over £700,000,000 a year more than our exports. What we can still set against that figure in the way of interest on capital invested abroad, freights, and other earnings it is impossible to say, but there can be no doubt that we are outrunning the constable to a very great extent. The consequence is seen in the huge debts which we have incurred to the United States and to neutrals in order to pay for them. The Chancellor of the Exchequer has recently stated that our debts to the United States will shortly reach the figure of £1,000,000,000, and unquestionably we owe great sums also to neutral countries. It is true that our Allies and ex-Allies owe us still more than we owe other countries, and that from that point of view our account still more than balances. But while we must reckon on having to meet all our obligations, we cannot be so certain of our debtors. Russia's debt of £570,000,000 sterling does not look good, and there are others whom we may not wish to press.

What our real loss is no one can calculate with any great degree of accuracy. It has been estimated, however, that the country will have lost well over £2,000,000,000 sterling of its capital wealth, or, in other words, perhaps about one-seventh of its pre-war accumulations.

The war, therefore, while causing an enormous increase in credit and currency and the usual evidences of wealth, has actually greatly reduced our real wealth. Until we have restored it to its pre-war level, our national income, and, therefore, our average prosperity, will be less than before the war, and we shall suffer from all the inconveniences of a scarcity of capital.

The reduction in our capital has, indeed, serious conse-

quences. Until it is restored the amount of wealth which the nation can produce is diminished. In other words, the national dividend, the sole source from which wages, interest, and profits are paid, is reduced. We may with good fortune rapidly replace our losses, but for the time being we shall be poorer. The smaller, too, the amount of capital—and by capital is not meant credit—the more restricted will be the opportunities for employment. And, lastly, the rate of interest which capital can secure from the total product of industry will be higher. All these are serious handicaps to the spread of greater well-being among the less fortunate sections of the population. They can only be removed by work and saving.

These great changes in the economic sphere have had a corresponding and serious reaction on our financial situation. Our vast foreign indebtedness, together with the inflation of credit and currency, has led inevitably to the entire suspension of the usual method by which we regulate the delicate working of our international financial machinery and our foreign exchanges. The pivot of all that machinery is the maintenance of the gold standard, the free import and export of gold, and in case of need, when the balance of our foreign account is against us, the raising of the Bank of England's rate of discount for the purpose of attracting gold from abroad and reducing trade and industrial activity at home. By these means we are accustomed to regulate our currency, our foreign exchanges, our level of internal credit, and our prices in relation to world prices. Since 1915 we have, however, been forced to regulate our foreign exchanges, not by the movement of gold or by the Bank of England's rate of discount, but by external borrowings. If these borrowings were to cease, our exchanges would immediately collapse. Similarly, with the abandonment of the gold standard, the automatic maintenance of our currency at par value with gold has ceased, nor is there any means at present of testing whether, and, if so, to what extent it is depreciated ; our level of prices at home is no longer kept automatically in harmony with external prices, nor is there any brake on the undue inflation of internal credit such as the Bank of England was previously able to apply through the raising of its rate, with its sobering effect on industrial activity.

III

Under the inexorable pressure of war we have, therefore, been swept from our old financial moorings and, as the above very brief analysis sufficiently shows, we have under compulsion embarked on an uncharted sea which, if persisted in after the arrival of peace, might bring us to the unlimited evils of great over-expansion and currency depreciation, leading to an ultimate collapse. Every other belligerent, except perhaps the United States, is accompanying us on the same journey. Most of them, indeed, have advanced a great deal further along the road. Nearly every prolonged war has in the past produced in greater or less degree the same results, whether we take France during the revolutionary wars, England at the end of the Napoleonic era, or the United States after the Civil War. In all of them we see over-expansion of credit and currency, rising prices and depreciated exchanges, symptoms familiar also in the history of every South American Republic. An extreme example may be found to-day in the new Russian Republic, where, as the writer was recently told by a traveller fresh from Petrograd, the peasants now *weigh* instead of counting their paper money.

None of these evils was to be altogether avoided in this country in the last four years. But if we are to recover financial health, they are to be remedied as soon as possible. That nation will recover quickest after the war which corrects soonest any depreciation in currency, reduces by production and saving its inflated credit, brings down its level of prices, and restores the free import and export of gold. These conditions, which are desirable for other nations, are to us, as the greatest importing and exporting nation and the financial centre of the world, essential.

With all our wealth of financial knowledge and experience behind us it should be easy for us to steer the right path—though it will not be always a pleasant one—amongst the dangers of the future. Every consideration leads to the view that the restoration of the gold standard—whether or not it can be achieved quickly—should be our aim. Only by that means can we secure that our level of prices shall be as

low as or lower than prices in other countries, and on that condition depends the recovery of our export trade and the prevention of excessive imports. Only by that means can we provide against and abolish the depreciation in our currency which, though the prohibition against dealings in gold prevents our measuring it, almost certainly exists, and safeguard ourselves against excessive grants of credit.

What, then, does the restoration of the gold standard involve? It involves some contraction at any rate of currency and credit, the cessation of great internal Government loans and Government borrowings abroad, the maintenance of high taxation to provide not only interest on War Loans, but a Sinking Fund for their reduction, the paying off by the public out of savings of the loans made to it by the banks, and the restriction of all unnecessary imports. It is not necessary to suppose that the process of contraction in this country need be very severe. It is unlikely that prices will for a long time, if ever, return to a pre-war level, and higher prices mean a higher level all round of credit and currency. Moreover, it is not certain that our prices even now are higher than those ruling in the other chief centres of the world. Some contraction, however, there must be. Contraction and falling prices are never altogether pleasant. It is not likely to be a period of buoyancy and elation, during which many new schemes are entered upon and when sometimes production makes a great bound forward. Profits artificially heightened by inflation are reduced by falling prices. The tendency towards rapid new development is checked. It is a period of digestion after too full a meal, and a period, too, when wages either fall or remain stationary. Nevertheless, if we can avoid serious troubles, financial and industrial, and guard against extensive unemployment, real wages, it is to be hoped, may remain as high if not higher than before. Wages do not usually fall as far or as quickly as prices. Rising prices are good for the promoter and the industrialist : falling prices for the wage-earner and those having fixed salaries and incomes. It is true that in a period of rising prices employment for the time being is plentiful and that the danger of falling prices is temporary lack of employment. While this is a danger which must be

guarded against, it is not to be avoided by the opposite policy of inflation, which, while perhaps giving us a further period of feverish activity, would ultimately lead to troubles from which our industry might not recover for years. There is no cure save through the increase of our national capital and our national dividend. If both are smaller than before the war, the amount available for labour and capital is smaller.

This is the hard truth which should be grasped firmly by our statesmen and politicians. There is a widespread opinion in favour of great extensions of credit and of vast schemes of Government expenditure. State guaranteed credit is to be the panacea which is to free us from all danger of stagnation and unemployment. This, indeed, is a seductive doctrine which has often led statesmen and legislators into a quagmire, and pressure in these directions will probably be strong.

It will be enforced by the very real and urgent necessity of providing employment for vast masses of men and women and by great and attractive schemes of reconstruction. Employment requires industry to be active, and industry is likely to say that the only thing required for activity is credit. That it must have sufficient credit goes without saying. But we should beware of the dangers we are running and guard against them. The buoyant optimism, which perhaps is the outstanding quality of Mr. Lloyd George, will unquestionably chafe at ideas of "contraction." But let him remember that he cannot avoid the operation of economic laws by ignoring them and that all history shows that the punishment of violating them is inexorable.

We may indeed expect to see revived and adapted to modern circumstances all the old controversies between the "cheap money men" and the "dear money men," between "contractionists" and "expansionists." In every age there have been many to urge that the remedy of such evils is not the painful process of contraction, but a further extension of credit and further issues of currency. Thus in Revolutionary France, Mirabeau passionately demanded the further issue of "assignats." Were they not secured on "real property, the most secure of all possessions, the soil on which we tread"? Just as in our day we are urged that the first and last condition

of reconstruction and the restoration of credit is the grant of unlimited advances under State guarantee against War Loan, "the premier British security." Mirabeau's policy was pursued until a pair of boots cost over £100 in the depreciated currency. Then the collapse came. In this country the inflation and depreciation resulting from the Napoleonic Wars were far less. But depreciation existed and a fierce battle ensued between those who desired inflation and those who demanded restriction, the victory ultimately resting with the latter. In the United States the Civil War between North and South left the currency immensely depreciated. Congress wavered too long before steeling itself to the inevitable measures. "The Government's financial recklessness was readily imitated by the community at large: debt was the order of the day in the affairs of both." "In 1873 this house of cards collapsed." "American prices, long out of joint with the markets of the world," fell to a normal level. "With the bursting of the bubble of inflated debt and inflated prices the excessive importations ceased." *

"A disordered currency," said Daniel Webster, "is one of the greatest political evils." "Ordinary tyranny, oppression, excessive taxation, these bear lightly on the happiness of the mass of the community compared with fraudulent currencies and the robberies committed by a depreciated paper."

It may be objected that no one proposes to depreciate our currency. But a further over-extension of credit would undoubtedly tend towards it. It is true that the over-manufacture of credit is by no means so fatal as the over-manufacture of inconvertible paper money. A Government has neither to put up security nor pay interest on paper money. A customer who demands credit from his bank must do both. Moreover, a customer is under pressure to repay or reduce his loan. A Government can only withdraw paper money with difficulty and by a complete reversal of policy. Nevertheless, an extension of credit, sufficient by increasing purchasing power again to raise prices, will involve an increase in currency and result in its further depreciation, with all its evils and dangers.

* *Forty Years of American Finance.* A. D. Noyes.

Moreover, admitting as every one will the necessity of credit for legitimate and productive objects after peace, we should still not delude ourselves into the belief that to create credit is to create wealth. However much we create credit we do not thereby create food or ships or raw materials. Credit is a means, and an invaluable means, of enabling us to utilize existing capital and wealth to the best advantage. But the real factors of production are labour and capital, and our creation of credit must bear relation to the amount of both available. The amount of capital—i.e., food, raw materials, manufactured articles, etc.—which we have in this country or shall be rich enough to obtain from abroad will probably be for some time more limited than before the war.

For the same reason we cannot permanently reduce the rate of interest by increasing the supply of credit. We may make "short" money easy. But the rate for permanent capital is determined by the supply and demand of real capital, not of credit.

Those who insist on the importance of credit to the exclusion of all other factors ignore and are inclined even to deny one cardinal point, namely, the intimate relation between our internal and our external problems.

We shall still perhaps be the greatest importing and exporting nation in the world. On the prosperity of our foreign trade depends the prosperity of our home trade. If our foreign trade fails to revive, we shall have much unemployment, reduced purchasing power among our people and stagnation. Our foreign trade is vitally influenced through the medium of prices, which is the link between our internal and external problems. If by an over-extension of credit internal prices rise, a danger especially to be feared since increased purchasing power would be exerted on a limited supply of materials, imports would be encouraged, exports impeded and extravagance stimulated. Our foreign exchanges would move more and more against us and we should be driven farther and farther away from a return to the gold standard. Ultimately, when we could no longer find means to pay for our imports, the whole structure would collapse. Our recovery after the war depends largely on the level of our prices being down to or below those

prevailing in other countries. Whatever course tends to increase them will be found prejudicial.

IV

The aim of the foregoing pages has been to bring into prominence certain principles which must guide our financial policy after the war rather than to lay down the exact measures which will have to be taken. As the Report, just issued, of the Committee on Currency and Foreign Exchanges states:

> These will depend upon a variety of conditions which cannot be foreseen, in particular the general movements of world prices and the currency policy adopted by other countries. But it will be clear that the conditions necessary to the maintenance of an effective gold standard in this country no longer exist, and it is imperative that they should be restored without delay. After the war our gold holdings will no longer be protected by the submarine danger, and it will not be possible indefinitely to continue to support the exchanges with foreign countries by borrowing abroad. Unless the machinery which long experience has shown to be the only effective remedy for an adverse balance of trade and an undue growth of credit is once more brought into play, there will be very grave danger of a credit expansion in this country and a foreign drain of gold which might jeopardize the convertibility of our note issue and the international trade position of the country. The uncertainty of the monetary situation will handicap our industry, our position as an international financial centre will suffer, and our general commercial status in the eyes of the world will be lowered. We are glad to find that there was no difference of opinion among the witnesses who appeared before us as to the vital importance of these matters.

While the unknown factors, of which account will have to be taken, are numerous, the general direction of the goal at which we must aim is clear. Nevertheless, that goal is likely to be difficult to reach, and in any case must, it is probable, be approached only gradually. The problem of the immediate employment of some eight or nine millions of munition workers and soldiers will be so vast and pressing and the results of failure possibly so calamitous, that the ulterior consequences of any means which may appear momentarily efficacious will run the risk of being disregarded. The Government will be urged to raise large sums for State undertakings and public

works of every description; industry will claim that its capacity to provide employment depends merely on the grant to it of exceptional credit; Labour is likely to protest against any policy which may involve not merely a fall in prices but also a fall in nominal wages, even though real wages do not fall at all.

While our statesmen should allow no pressure to weaken their grasp on the fundamental conditions of our financial and industrial prosperity as outlined above, it is obvious that a policy involving changes in existing conditions must be gradual. Violent changes are destructive of industry and trade. Confidence is the basis of credit. With instability confidence disappears, legitimate trade and commerce cease and speculation takes their place. The equilibrium between production and purchasing power, on which stability depends, is difficult enough to maintain even in normal times. The war equilibrium is wholly artificial, and a normal peace equilibrium will be extremely difficult to attain without violent oscillations caused by abnormal conditions both in our own and other countries. A too rapid fall in prices might produce both an industrial and a social crisis. The return to more normal conditions, while deliberately pursued, should accordingly be gradual. Government expenditure will inevitably be very large for some time to come, and Government loans may be required for large public undertakings. A good deal of expenditure of this kind can hardly be avoided, notwithstanding the urgent necessity for the cessation of Government borrowing or at least its reduction to the narrowest limits. But we should embark upon it with our eyes open, and it should be carefully scrutinized to insure that it is not merely not wasteful but really reproductive socially and economically.

Similarly, in the case of credit facilities, it would be foolish to seek to reduce over-expansion at once by refusing to industry what it legitimately requires. Our banking institutions must be ready for considerable demands. It is true that British industry has had enormous sums spent on it during the war and has, in many ways, been entirely renewed. But large sums will no doubt be required to re-equip it as a peace and not a war machine. Whether credit in sufficient amounts will be available from existing institutions is a matter on which

opinions may differ. In view of the limited supplies of materials in many directions, and probably the world's reduced purchasing power in many directions also, there is a risk of exaggerating what will be required. Over-production and a glut is to be avoided as much as under-production, and there seems no good reason why existing credit institutions should not be able to provide all reasonable banking facilities. Their ability in this direction will depend largely on the reduction by the Government of its floating debt, which the banks hold in large amounts, and on the saving powers of the community, enabling it to repay advances made by them.

The question of the supply of permanent capital on a large scale to British industry is somewhat different. It is arguable whether the financial machinery of London is particularly well adapted for assisting large-scale British industry to get into touch with the British investor. It has been urged that there was room for one or more institutions which should devote themselves more particularly to the financing of British industry and the issuing of industrial securities to the British investor. Large new institutions have since been created, but whether they propose to attempt to fill this particular gap appears uncertain.

Much will depend on the attitude of the British investor towards industry. For a good many years he has preferred foreign and colonial rather than home industrial securities. If he is convinced that British industry will henceforth offer a secure and attractive field, sufficient capital should be forthcoming. If, on the other hand, troubles between labour and capital, restriction of output, undue Government interference and the handicap of a profits tax, which, at any rate as at present constituted, is equally harmful both to labour and capital, render investment both insecure and unprofitable, industry will undoubtedly suffer from lack of capital and a very high rate of interest. It is to the interest of all parties to prevent this misfortune, since industry must look in the main for its money not to Government loans or temporary banking credits, but to the savings of the investor.

The most difficult problem before us, and the one which may most retard any return to a free gold market, is our

foreign indebtedness. It is on the settlement of this question that the condition of our foreign exchanges will in the main depend. A free gold market immediately after the war might result in all our gold being drained away at once to meet the enormous claims of foreign nations upon us. It will require time to settle the most pressing of them and to arrange that so far as possible the repayment of a great part is postponed till a more convenient season.

If, as one may hope, this question can be treated in a broad and satisfactory way both by the Governments and the banking institutions concerned, the greatest obstacle to a speedy recovery of our exchanges would be removed.

V

The task before Governments and Parliaments in the next few years in following the strait and narrow way in finance is not likely to be an easy one. But the danger that they may fall into temptation is not by any means the only one ahead of us. While a bad financial policy may easily ruin the most industrious and thrifty nation, a sound one will not of itself achieve anything without effort and sacrifice on the part of all. Our financial prosperity is not to be secured by any juggling. It depends in the last resort on the nation having a surplus of income over expenditure, of production over consumption—on its repairing by economy and hard work the losses and waste of war.

It is doubtful whether our minds are sufficiently prepared for the difficult times in store for us, whether, indeed, as a whole, we are not in blissful ignorance of the efforts and sacrifices which we shall all be called upon to make. The foundations of our economic structure are clear to very few, and the experience of the great bulk of the population during the war has been such as entirely to mislead them as to its economic consequences. Our national wealth is much less, but our people have much greater expectations. They are not aware that their easier times during the war have been made possible only by the most spendthrift—necessarily spendthrift—course. They are far from foreseeing that it will be harder, not easier,

for a time at any rate, than it was before to maintain the pre-war standard of life, and that no change, however radical, towards socialism or national guilds or any other alleged means of securing a better distribution of wealth as apart from its production, can alter this hard fact. It is of the first importance that the main elements of the economic problem should, if possible, be brought home to them.

The Chancellor of the Exchequer has recently informed us that before the war our total national income was estimated at roughly £7,000,000 a day, or, divided equally among 45,000,000 men, women, and children, about 3*s*. 4*d*. per day per head. The great rise in prices would by now have perhaps doubled this sum, measured in money. But the real income measured in goods is not more, but less, since our production of peace goods, together with what we buy or secure as tribute from other nations, will be less than it was before the war. If, therefore, our national income were absolutely equally divided, something over 3*s*. a day at pre-war prices is what we should each get; that is all we obtain by our productive efforts, or as a return for capital or services lent to other nations. It is not a princely sum; it would, indeed, be for a great many people a good deal more than they get now; for a good many a little less; for a good many more vastly less. Even that sum can only be obtained if our productive effort is as large as it was before the war. If we work less hard, or reduce production by internal strife, we shall get less.

The efforts of most reformers, radical and otherwise, are bent at present on the better distribution of wealth, an aim which will have every one's sympathy. It is essential that we should secure a fair standard of life to every one who will work. But there is a danger that the movement against capital and enterprise, against interests and profits, which is so widespread among the workers to-day, will lead them into courses fatal to themselves and the whole community. It is not surprising that the distribution of wealth should appear to them more important by far than its production. Their gain from increased production is often small, while their resentment has been fanned during the war by flagrant "profiteering," for which conditions have given such ample

opportunity. Yet it may be urged with great force that the distribution problem can only be successfully tackled through that of production, and that if labour thinks only of distribution and forgets production, we shall have little chance of recovery. The best distribution in the world—if an equal distribution is the best—would give us each something over 3*s*. a day (at pre-war prices). If profits are reduced till there is no incentive to enterprise, and the return on capital is reduced till there is no incentive to saving, the national income will be immediately and disastrously reduced, and the average savings per head with it. The consequences of thinking only of the distribution of wealth as distinct from production is seen at this moment in Russia, where the great proportion of factories is likely before long to be closed, and the town population at any rate to be without the necessities of a civilized life. Russia is not an industrial state. The great bulk of its population is agricultural and can itself produce the primary necessities of food and clothing. It can therefore live its simple life, even under Bolshevist anarchy. But a similar experience would reduce a highly organized industrial and importing community like ours after a few weeks to general ruin and starvation.

The corollary of better production is increased saving, so that we may economize our consumption of what we produce, and thus increase our exports, diminish our imports, and so re-establish our financial position. We have always been a wasteful nation, and while the war has wrought a great change in the nation's habits of thrift, there is still room for much improvement both among the general community and also in Government departments. Wastefulness by the rich is much more blameworthy than wastefulness by the poor. The poor damage themselves; the rich damage others, not themselves. It behoves the rich, therefore, to set the proper example. A study of Mr. Hartley Withers's excellent book *Poverty and Waste* is recommended to every one who regards extravagance as beneficial to the community.

But for the less well-off, too, economy is, in their own interests, imperative. It is a matter of first-class importance to make permanent these habits of saving which the National

War Savings Movement has done so much to create. It is useless to hope for better distribution if higher wages mean merely extravagance. That is the certain way of making the rich richer and the poor poorer. The wealth which the wage-earners earn is immediately diverted again into the pockets of the capitalists, great and small.

There should be some easy and attractive method of investing small savings, and there seems every reason, therefore, why the Government should continue permanently its machinery for encouraging saving and investment in Government securities.

There are to-day 17,000,000 persons each possessing Government securities of one kind or another. It is important that these persons should all continue the habit of investment so formed, that their number should be increased, and that the opportunities offered them during the war should be continued.

VI

The whole nation is looking forward with eagerness to a bold, far-reaching and effective policy of reconstruction. There is so much that urgently requires doing. An improvement in the often wretched and disgraceful conditions of housing, upon which all other reforms largely depend, higher wages, a higher standard of life in general, a permanent improvement in agriculture, great schemes of industrial development, all these are urgently called for, nearly all of them absolutely necessary. To many who earnestly desire to see established at once " a new heaven, and a new earth " it will be distasteful to face the financial and economic difficulties which have been outlined in the preceding pages. Yet, since they cannot be evaded, our success in reconstruction depends on our facing them, learning the salutary lessons they teach us, and then overcoming them. There is no need for pessimism. They can be overcome, but only on one condition. Mr. Lloyd George, to whom our country owes an immeasurable debt, is stimulating us with a great hope, a hope for a better and happier life for all. Let him use his great power to impress equally strongly upon his countrymen that this hope can never be fulfilled except by sacrifices, and by hard work, by

every labourer being worthy of his hire. The greatest sacrifices—measured at any rate in worldly wealth—must be made by the rich. The heavy burdens to be borne must be shared according to the ability to bear them. But that is only the beginning. The reconstruction of our national life is not a matter of "ninepence for fourpence." It can only be secured by the joint efforts of a united nation.

VIII

FINANCE AND REPARATION

(June, 1919)

I

The view has always been held in some quarters that the end of the war would see a great and immediate development of industry and trade and very considerable prosperity, at any rate for a limited period. That is not our opinion. The resumption of normal conditions can only be gradual. Credit and confidence are now largely lacking, and their restoration to pre-war standards must necessarily in any circumstances be a matter of time, and dependent on the gradual readjustment of all the political, economic, financial and moral disharmonies caused by the war, and also on the reaccumulation of some at any rate of the vast amount of capital which has been destroyed. It is certain that whatever we do, European standards of living have for some time got to be lower than before the war. Few people in England realize the terrible conditions of life in very large parts of Europe where everything is lacking, even food, and where industries cannot get started because they have not even the raw materials with which to begin. Even in the countries near us, like Belgium, we do not realize the enormous obstacles which prevent industry getting thoroughly under way. Belgium has lost her markets; most of her neighbours have little purchasing power, currency and exchanges are depreciated; prices are very high, she cannot compete against American and Japanese products. The same is true, more or less, of all nations, including our own, and many, of course, are in a vastly worse condition even than Belgium. We all of us are dependent on the prosperity of each other,

and we must all go ahead hand in hand together. If our neighbours are poverty-stricken, we shall be poor.

Consider for a moment the difficulties of the other great European Powers. France has lost between one and two million of her best men. A considerable part of her industry is for the time being ruined. Her coal mines are useless for some years. Moreover, French investors were either not so far-sighted or so lucky as British investors. While the British invested, in the main, in the New World, the French investor lent his money to European Governments, to Russia, to Austria-Hungary, to Turkey, or to the Balkan States. In consequence, France, which before the war drew an income from abroad of perhaps £120,000,000 a year, will now draw practically nothing, at any rate for some years. Again, France exported particularly articles of luxury of all kinds. These are the trades which will be peculiarly hit by the poverty of Europe. France has also great difficulties of internal finance. What she must look forward to as her normal annual expenditure is very far from covered by her taxation. Her currency has increased nearly eight times above what it was at the beginning of the war; prices are vastly higher than in England, and it is probable that the actual depreciation of the franc is as yet far from expressed in the rate of exchange, which at the moment of writing is over 31 francs to the £. If this is so, the export of goods from France will be greatly handicapped. Added to all this, France is faced with an external debt of about £900,000,000 owing to us and to the United States.

As against this, France has, of course, gained great wealth by the acquisition of Alsace-Lorraine. The economic effect, however, will not be felt immediately, and meanwhile it is imperative for French credit that her Government should pursue a stronger and a more decided policy of internal financial reform.

Take, again, the position of Italy. Of all European countries, Italy has to import the greatest proportion of raw materials. She has no coal, and few other raw materials. The resources which she possessed for the purpose of balancing her trade were the export of manufactured articles, the money remitted home yearly by the very large number of her emigrants, and

the expenditure in Italy of tourists. All these sources of wealth have either disappeared or been greatly diminished. Take as an example the silk trade, one of the most important of Italian industries. What markets is Italy now to export to ? The Central Empires will be too poverty-stricken to buy such articles of luxury in great quantities, and, on the other hand, the markets of the New World, and particularly of the United States, have been captured by Japanese competition. Similarly, the important Italian trade in early fruits and vegetables to Central Europe is likely to be very badly hit by the diminished purchasing power of the enemy countries. Even the famous macaroni is now, since the war, manufactured in Canada and the United States.

As to emigration, the war has brought a changed world. Germany, to which normally a large number of Italian emigrants went every year, will now have in all probability to export her own population instead of receiving the population of others. German emigration is likely to compete with Italian in other parts of the world, and it is possible that countries like the United States will impose greater restrictions than hitherto on indiscriminate immigration.

Italy also is loaded with a vast external debt of about £700,000,000. How can she pay the interest on this and also buy her raw materials ? In 1918 her imports were about ten times as great as her exports, and while Peace will bring, no doubt, a reduction in imports, her position is one of the greatest difficulty.

In the main, German conditions are not dissimilar. It is true that during the war Germany has incurred no great foreign debt, but that deficiency will be supplied, and on a scale far greater than in the case of any other nation, by the Reparation Terms of the Treaty of Peace. It is true, also, that her factories are intact. Nevertheless, she is bare of raw materials, and her whole financial and economic structure is being strained to the breaking point. Her currency is in vast superfluity ; the mark is now worth only between 3*d*. and 4*d*. instead of 1*s*. ; prices are very high ; her workmen are demoralized and debilitated by the conditions of war and the constant underfeeding of four years. It is impossible to see how internal bankruptcy can be

avoided, and a general scaling down of debts. It is equally difficult to see what effect this would have on the stability of her great banking institutions. Germany can only get to work again if she can obtain large credits from abroad for the purchase of raw materials. Unless she gets to work she cannot possibly pay the indemnities demanded of her. Members of Parliament who demand that she shall pay the whole cost of the war, and regard the Reparation Terms as lenient, are invited to suggest some solution of this dilemma.

The economic conditions of all the smaller countries of Europe to the east and south-east are worse even than those of Western Europe. Famine and distress are more acute. They have more chaotic currencies and greater political troubles. Several of them are conducting minor wars amongst themselves. All of them are practically without means of purchasing raw materials. The same state of affairs, to a still greater degree of acuteness, exists in Russia. In all these countries the future depends in the main on political stability and peace. They are mainly agricultural, and they can quickly recuperate, provided they have peace, and provided they are supplied upon credit with the first necessities of existence and of agricultural production. There are some large industries, it is true, in Poland and Czecho-Slovakia, which offer difficult problems, but they are problems which should be capable of solution through the assistance of friendly Powers, such as the British Empire and the United States.

The position of Great Britain is better than that of any other European Power. Our troubles are of the same general character, but they have not reached the same intensity. Our selfish interests might tempt us to ignore the Continent of Europe, and find a market for all our exports in the New World. But such a policy would be impracticable. It is essential that we should trade with Europe, and at present, if we trade, we must trade on credit. We ourselves have a large adverse balance of trade. We are not therefore in reality in a position to give credit, and can do so only at some risk. To some extent at any rate we must run that risk and rely on ourselves obtaining the additional credit we require in consequence from the United States. Our power to come successfully through the ordeal

of the next few years will depend on our capacity to export, and that will depend in turn on our costs of production comparing favourably with those of our competitors. To balance our foreign trade and regain a stable exchange is of vital importance. We can pull through, but only by the exercise of the greatest possible efficiency, hard work, and economy by all classes.

As against a Europe impoverished and in the deepest distress, stands the United States with greater wealth and greater resources than ever before in her history. It is impossible that these two continents, the one overflowing with materials of all kinds, the other destitute and famishing for want of them, can face each other without finding somehow or other some plan of mutual co-operation. Europe needs the assistance of the United States, but the United States also needs the assistance of Europe. Unless Europe is given credit it is impossible for her to buy the exports which the United States desires to sell. It is for the United States to devise whatever methods most recommend themselves for giving the necessary credit to Europe, just as, in past years, Europe has built up the United States by the same means.

As the unparalleled situation, which is not yet fully developed, reveals itself in complete clearness, it will probably be found that the problem is too great to be solved by private credit alone. It must be remembered that the increasing population of the great industrial states of Europe has only been supported by a highly developed industrial organization working at full speed and by a complicated system of international interchange of goods. That organization and that system lie smashed and wrecked. It is questionable with what speed they can be restored. Even if credit is supplied in sufficient quantity, there are many other obstacles to a speedy recovery. A thousand and one readjustments require to be made before the great machine can revolve again smoothly and rapidly. Meanwhile how is the population to live? Germany, for instance, could provide a decent standard of life for her large population and absorb annually an increase of something like a million souls only by a highly intensive industrial system working at full speed. How can this population be maintained with the

machine at half or quarter speed? The same problem, in a different degree perhaps, faces France, Italy and Belgium. An equilibrium must be found between the numbers of the population and the means of subsistence. In Russia it has been found, it appears, partly by starvation, partly by a drastic change in occupation. In other words, the urban population has somehow been absorbed by the country and found there at least a bare means of subsistence.

How is this equilibrium to be reached in the rest of Europe? On the one hand by restoring production as soon as possible; on the other by emigration, or, if that is not possible, by drastic changes, either in occupation or in the standard of life, so that the means of subsistence available may at least keep the people alive. It is clear that if the greatest suffering and unemployment, and in consequence the greatest social disorders, are to be avoided, every means must be utilized to get the wheels of industry moving.

The first and indispensable condition is the supply of raw materials. Europe has lost its working capital. It must be supplied to her and supplied on credit. The needs are on so vast a scale that private institutions such as banks, exporting corporations and so forth may not be able to cope with them. Certainly our reduced financial strength makes that more than probable in England. In the United States resources are so vast that private credit may possibly do all that is necessary. If so, so much the better. But if not, and if Government assistance can alone save Europe from sinking into the abyss, Congress, we believe, will not hesitate to authorize the United States Government to lend the assistance required. The interests of the whole world, and those of America included, are so profoundly involved that it is impossible to doubt it.

Nevertheless, while Europe must be helped over the first stile, let us not forget that a country's wealth consists in its own resources and its own labour. For us to borrow resources from another country merely adds to our obligations, which we must some day redeem. That countries already so vastly indebted to America should get still more deeply into debt may be necessary, but is unfortunate. The huge indebtedness of Government to Government, indebtedness which at

best can be redeemed only over many, many years, is unhealthy and undesirable. Only absolute necessity can justify its increase.

In the main the European countries impoverished by the war must work out their own salvation. They can no more be restored by charity than can an individual. The United States and other countries enriched by the war can and should lend them credit. But in the end it is only by their own sacrifices and their own efforts that they will pull themselves out of the mire.

II

The peoples of Britain, France, and Belgium have been led to hope that many of their financial and economic troubles will be solved by the vast indemnity which is to be obtained from Germany. Members of Parliament in England have, in their innocence, and misled by their betters, given pledges which cannot possibly be fulfilled, and unfortunately persist in giving vent to opinions and exciting hopes which are inevitably doomed to disappointment.

Germany has undertaken to pay reparation for the damages she has so criminally caused, and it is mere justice she should pay all that she has undertaken. Over a long period of years she may be able to do so. What she can pay per annum twenty years hence no man can say. What she can pay in the next five will be limited by the extent of her recovery, and in any case cannot be large enough very seriously to alleviate the great financial problems which within that period the nations of Western Europe must have solved. What are in detail the Reparation Terms in the Peace Treaty it is not intended to discuss here. Nor is it of consequence, since the course of economic events in these next few years will be determined by facts which are in substance unalterable. Germany will not be the Germany of 1914. With Alsace-Lorraine, Upper Silesia and the Saar Valley lost to her, with her mercantile marine and her foreign securities gone, with a disordered currency, a vastly depreciated exchange, financial burdens which she can hardly meet in full, with the population demoralized by four years of strain and underfeeding, with the most grave and

pressing political problems to face, and with her markets gone, her producing power and her export capacity must be for the present gravely diminished. France and Italy do not expect to balance their external trade for two or three or four years. It is out of any surplus on her foreign balance of trade that Germany can alone—apart from any immediately available assets—pay an indemnity. Why should Germany be able to do the miracle that France and Italy cannot do, and not only balance her trade, but have great surpluses in addition to pay over to her enemies? Before the war her imports exceeded her exports by about £70,000,000. The deficit was made good, and no doubt very considerably more than made good, by "invisible" exports—e.g., freight, interest and commissions. But these invisible exports will have almost entirely disappeared. Germany therefore—and a very different Germany—must turn an adverse balance of £70,000,000, which existed at the time of her greatest prosperity, into a favourable balance before she can pay anything over and above her liquid assets. What she can pay in future will depend on how large that favourable balance will be. Let us, if we are wise, moderate our expectations. If, as soon as peace is declared, Germany is given assistance and credit, she can pay us something, and should pay all she can. But what she can pay in the next five years must be, we repeat, limited. If, on the other hand, we take away from her all her liquid assets, and all her working capital, if, furthermore, she is bound in future to make yearly payments to an amount which will in any reasonable human expectation exceed her capacity, then no one outside a lunatic asylum will lend her money or credit, and she will not recover sufficiently to pay anything.

Those who advocate the simple and attractive solution that Germany should pay us, and everybody else too, the whole cost of the war—may possibly have forgotten to examine the question, what form she would pay in. If they ventured into detail to that extent, they might ultimately grasp the truth that, apart from any existing assets of value outside Germany, she can pay only in exports, and the additional important truth that Germany's exports are in the main of a character which compete especially with British exports. A vast indemnity,

the great bulk of which must go to other countries, will, therefore, act as a forcing house to German exports to the detriment of British trade. The German will have to live hard, eschew all comforts, achieve the utmost heights of efficiency and organization in order to pay many nations what he owes them, and in so doing will incidentally drive British trade out of the market or compel us to live after the same manner.

While, therefore, justice demands that the German shall in the course of time redeem his bond, he cannot in the next few years solve by the sweat of *his* brow our financial and economic problems. It is by the sweat of *our own* brows that we must do so.

III

What, then, is the German's bond ? On January 8, 1918, President Wilson, in a formal message to Congress, enunciated certain principles upon which he submitted that the war should be ended. In Articles VII, VIII, and XI of the Fourteen Points contained in that message he stipulated that the invaded territories of Belgium, France, Roumania, Serbia, and Montenegro must not only be evacuated, but " restored."

On October 4 the German Government accepted these fourteen points as a basis for negotiations for an armistice, which they asked the President to request the Allies to open.

On November 5 the President communicated to Germany a Note drafted by the Allied Governments assembled at Versailles, in which they declared " their willingness to make peace with the Government of Germany on the terms of peace laid down in the President's address to Congress of January 8, 1918," subject to two qualifications, the second of which was stated as follows :—*On January* 8, 1918, *the President declared that the invaded territories must be restored as well as evacuated and made free. The Allied Governments feel that no doubt ought to be allowed to exist as to what this provision implies. By it they understand that compensation will be made by Germany for all damage done to the civilian population of the Allies and to their property by the aggression of Germany by land, by sea, and from the air.*

It is important to note that these words were drafted by the

Allied Governments in Versailles, and not by President Wilson in Washington.

These terms govern the question of reparation. All demands on Germany must clearly in honour fall within them. Arguments are used even in responsible quarters to the effect that, since the Fourteen Points did not mention either Reparation or Indemnity, the Allies are at liberty to make what claims they like in respect of either. We do not share this view. From the moral, if not the legal, point of view, it is excluded in our view by the subsequent correspondence quoted above. Else what reliance could be placed by the Germans on the terms to which they had agreed, if a matter of the vital nature of an unlimited indemnity could be imported later. Whether the Allied authorities were wise or unwise when in the first days of November they agreed at Versailles to peace on these terms, whether, had they known of the full extent of the German *débâcle*, they would have framed their demands otherwise, all these questions are beside the mark. It was on these terms and in reliance on their fulfilment that the German nation laid down its arms.

What, then, do they imply to the plain man ? The President demanded that Germany should " restore " as well as evacuate the invaded territories of Belgium, France, Roumania, Serbia and Montenegro. The Allies wished to make clear what this provision meant. They knew that other countries which had not been invaded had also suffered similar kinds of damage from Germany's aggression, that England had suffered from air raids, and far more important, that the British Empire in particular had suffered enormous damage from the illegitimate submarine campaign, which was especially directed against civilian life and property. It was clearly necessary and justifiable to extend the President's definition of restoration of invaded territories to cover these cases. Germany was therefore to pay compensation for all damage done to the civilian population of the Allies and their property by the aggression of Germany by land, by sea, or from the air.

Clearly Germany must pay for physical damage to life or property inflicted on civilians ; clearly she can be called on to pay for the damage direct and indirect to civilians and their

property due to the illegitimate submarine campaign, or in other words, for much more in certain directions than as it appears is actually demanded of her. But can we ask her to pay compensation arising out of her soldiers killing or wounding our soldiers? How does that come within the terms? Can we demand from her, as it appears we do, from the published Summary of the Treaty of Peace, the cost of pensions to widows and orphans and to the wounded and crippled soldiers and sailors themselves? How is that "damage done to the civilian population of the Allies and their property?" Is it on the ground that some of the men who earned the war pensions are no longer soldiers or sailors? That argument seems to us groundless, for in that case the word "civilian" has no meaning and would exclude no one.

If the soldier's pension is damage, why not the soldier's pay? And if that, why not the cost of shells and guns, and, in fact, every expense arising out of the cost of the war? It might be urged that we were entitled to say that Germany should pay all such expenses. Certainly we were. But we did not say it. It would be ridiculous, if we really intended to make so wholesale and definite a claim to have done so by merely extending and defining President Wilson's demand for the restoration of invaded territories. If we were claiming the whole cost of the war, the most inexperienced draftsman could in two minutes have framed words which would have admitted of no dispute. We did not do so, and this meaning cannot, in our opinion, honourably be read into the words we used.

It is imperative in our view that the Government should make public the grounds on which these claims are based and the reasons why they were made in this form, and so convince the nation that in making them it has justice and honour on its side. So far as the sum to be exacted from Germany is concerned, the matter is of small importance, and might be held to be one of form only, since it would probably be easy to claim from Germany in strict accordance with the terms she has accepted all and more than all she can possibly pay. But on other grounds its importance cannot be exaggerated. We have been fighting above all to vindicate the sanctity of treaties. In peace our first duty is to sustain this principle by our example.

IX

THE FINANCIAL AND ECONOMIC SITUATION

(SEPTEMBER, 1919)

The greatest danger which threatens us is the chasm which lies between appearance and reality, between reality and what the bulk of the nation believes it to be. If all sections of our population saw the chasm in front of us and made up their minds that it must be bridged, we could easily do so. Our danger is that, not foreseeing it and blinded by internecine strife, as we approach it, we shall fall into the abyss. Perhaps an equal risk is that, in our ignorance of the real conditions of our economic prosperity, we shall, when the dangers are too close to be ignored, embrace any panacea which may be nearest at hand in a vain hope that it may work a miracle.

We are deceived by our appearance of prosperity. Never has there been so much "money" about: great classes of the population either are, or at least feel that they are, better off than they have ever been; profits in most trades are abounding; deposits in the banks go up by leaps and bounds; there is every symptom of feverish prosperity which accompanies rapidly rising prices. Yet all the time the upward movement continues; the inarticulate possessors of "fixed incomes" are slowly ground between the upper and nether millstones of taxation and high prices, and the whole economic fabric becomes more and more undermined.

Every financier and economist and all past experience tell us that such a state of affairs cannot last for ever, and must, indeed, if long pursued, end either in a sudden collapse or more or less prolonged depression. But, if we do not understand the grounds for these predictions, they will not be heeded, until

the trouble begins. Indeed, they will merely confirm that disbelief in expert opinion which our seeming prosperity for five years through the course of a gigantic and costly war has spread far and wide. It is incumbent, then, on economists who hold this opinion to make some effort to show the real facts, to predict in what manner the existing situation will develop, and to suggest what safeguards and remedies may be applied.

I

One effect of the artificial conditions in which we are living has been to intensify the general belief on the part of the people that there is any amount of wealth to make every one comfortable, if it could be got hold of, and that it is their business—almost their duty—to "have a shot at it," since by so doing they will benefit themselves and the whole nation.

While every one will admit the imperfections of the existing distribution of income and the great need to make England a better place to live in, there could unfortunately be no greater delusion than to believe that any redistribution can make our wealth really sufficient. There is ample proof that the increase of wealth is even more important than its better distribution, and must, in fact, precede it. Indeed, no proper perspective for the consideration of the questions which are now agitating the nation can be obtained, unless the true facts with regard to the national income are thoroughly grasped. Since, in the economic sphere at any rate, they govern the whole matter, it is worth while to restate them briefly.

The most authoritative statement is to be found in Dr. Bowley's recent work,* in which he analyses the national income as it stood just before the war. His exhaustive and able statement should be read by every one. His general conclusion, amply confirmed by the figures which he gives in detail, is that "the spendable wealth of the nation derived from home industry has been grossly exaggerated by loose reasoning." Before the war the home income would "not have yielded more than £230 gross annually per family of five

* *The Division of the Product of Industry. An Analysis of National Income before the War.* Arthur L. Bowley. Clarendon Press.

or £170 net after all rates and taxes were paid and an adequate sum invested in home industries. The income brought home from abroad amounted to about £90,000,000, or £10 a family. The average family is not, however, five, as is frequently assumed, but about four and a half persons; the number of households is not 9,000,000, as just taken, but about 10,000,000, and the average net income of a family would have been £153 from home product, or £162 if income from abroad is included. If this sum is compared with pre-war wages it must be remembered that there are on an average nearly two earners to a family."

Again Dr. Bowley points out that about 60 per cent of the total national income goes to those whose annual income is under £160. The balance of 40 per cent goes to the 1,100,000 income tax payers and their families; but of this 40 per cent a considerable proportion is earned as salaries or by farmers, and a further still larger portion goes to pay rates and taxes and to provide the sum which has yearly to be reinvested in industry. He further calculates that the average salary of all salaried persons paying income tax was about £340, and that the average profit of all persons assessed to profits over £160 can be roughly estimated at £500 per annum. Finally he calculates that on the extreme assumption, first, that every earned income in the country was reduced to £160 per annum, and second, that the whole of the balance so saved, together with all unearned income, was transferred to national purposes, only about £200,000,000 to £250,000,000 (at pre-war figures) would be available. "This sum," continues Dr. Bowley, "would have little more than sufficed to bring the wages of adult men and women up to the minimum of 35*s.* 3*d.* weekly for a man and 20*s.* for a woman, which Mr. Rowntree, in *The Human Needs of Labour*, estimates as reasonable." In actual fact nothing approaching this sum would be available. To cut down all earned incomes to this limit and to confiscate all unearned incomes would without doubt largely diminish the production of wealth, at any rate for the time being, by the dislocation caused and by the diminution of the incentive to save or to go in for new development.

As regards profits, Dr. Bowley's calculations are as follows :—

"In the whole group of industries for which we have adequate

information, taken all together, excluding railways, it is found that 58 per cent of the net product (after all other expenses and depreciation are met) goes to manual workers, 4 per cent in small salaries, 6 per cent in salaries over £160: in all 68 per cent goes to those employed. 32 per cent is left for royalties, rents, interests and profits, advertisement, etc., and this is reduced to 23 per cent if we count our royalties (as not being the result of the efforts of employed) and allow 4 per cent for the necessary repayment of or interest on capital invested. How far this 23 per cent, or £133,000,000, together with a relatively small sum (probably well under £10,000,000) for the salaries of managers of companies, is an excessive or unnecessary remuneration for the organization of industry employing 6,000,000 wage-earners and £1,200,000,000 capital, and producing £340,000,000 wages, is a question that may properly be debated. It is this sum that formed the only possible source of increased earnings in this group with industries conducted as before the war and production at its then level. In fact, while in some industries a considerable advance may have been practicable, in the majority no such increase as would make possible the standards of living now urgently desired and promised in the election addresses of all the political parties could have been obtained without wrecking the industry, whether by stopping the source of further investment or closing down firms whose profits were low. This statement in its general terms cannot, it is thought, be reasonably denied by any one who has studied the facts."

Dr. Bowley's conclusion is that "there is no hopeful way of dealing with the state of affairs portrayed by these statistics, except by increasing production, care being taken that the increased product is well distributed." All the improvements as regards labour and capital necessary for increased production will, however, need time, skill and patience, and they have not yet taken place. "There is a great risk of disappointment and failure if there is an attempt to grasp the fruits of progress before the tree that might produce them has been cultivated. This analysis has failed in part of its purpose if it has not shown that the problem of securing the wages, which people rather optimistically believe to be immediately and

permanently possible, is to a great extent independent of the question of national or individual ownership, unless it is seriously believed that production would increase greatly if the State were sole employer. The wealth of the country, however, divided, was insufficient before the war for a general high standard; there is nothing as yet to show that it will be greater in the future. Hence the most important task—more important immediately than the improvement of the division of the product—incumbent on employers and workmen alike, is to increase the national product, and that without sacrificing leisure and the amenities of life."

The figures given by Dr. Bowley are supported by Dr. Stamp,* another competent authority, in his recent estimate of the Wealth and Income of the Chief Powers. Dr. Stamp's interesting analysis is reproduced on page 202.

What is the broad lesson we can draw from the figures of Dr. Bowley and Dr. Stamp? It is that in all countries man has not yet done much more than draw from nature by hard toil and labour the bare necessities of life. Nature is not bountiful, or perhaps man, presuming on her bounty, multiplies too rapidly. In no country is there any vast store of surplus wealth. We are better off than most, but only owing to our natural resources and to the efforts and savings of past generations. And our wealth, such as it is, has been secured only by a vast and intricate system of national and international division of labour and exchange of our goods against the goods of all foreign countries. It is no easy matter daily to feed, clothe, house, transport and provide some amenities of life for 45,000,000 souls on these small islands. It is almost a daily miracle that we do so and it is done only at the cost of highly complicated industrial society involving very great specialization, which has many drawbacks, and against which we seem now to be rebelling. The profound dissatisfaction which is evident in every great industrial country is not unnatural. Our modern civilization is an unlovely thing. Never before in history have such vast masses of men been called upon to toil in surroundings which divorce them so completely from that nature in close

* *The Wealth and Income of the Chief Powers.* J. C. Stamp, C.B.E., D.Sc. Royal Statistical Society, 1919.

Summary Table, showing the estimated Wealth and Annual Income of various Countries at the outbreak of War in 1914, and the approximate accuracy of the respective estimates.

Country.	National Capital.			National Income.		
	Approximation to accuracy: Grade.*	Amount in million £.	Amount, per head of population.	Approximation to accuracy: Grade.*	Amount in million £.	Amount per head of population.
			£			£
United Kingdom .	I	14,500	318	I	2,250	50
United States . .	II	42,000	424	II	7,250	72
Germany . . .	II	16,550	244	I	2,150	30
France	II	12,000	303	II	1,500	38
Italy	III	4,480	128	IV	800	23
Austria-Hungary .	III	6,200	121	IV	1,100	21
Spain	IV	2,940	144	IV	230	11
Belgium . . .	III	1,200	157	—	—	—
Holland. . . .	III	1,050	167	—	—	—
Russia	IV	12,000	85	—	—	—
Sweden	III	940	168	—	—	—
Norway . . .	IV	220	90	—	—	—
Denmark . . .	IV	500	176	—	—	—
Switzerland . .	IV	800	205	—	—	—
Australia . . .	I	1,530	318	I	258	54
Canada	II	2,285	300	IV	300	40
Japan	IV	2,400	44	III	325	6
Argentine . . .	III	2,400	340	—	—	—

* Grade I. Estimate is not likely to be inaccurate to a greater extent than 10 per cent.
" II. Estimate is not likely to be inaccurate to a greater extent than 20 per cent.
" III. Estimate is not likely to be inaccurate to a greater extent than 30 per cent.
" IV. Estimate *may* be inaccurate to a greater extent than 40 per cent.

touch with which man has through countless generations lived. Never before have they had to work so mechanically and monotonously. The people of Erewhon, in Samuel Butler's

great satire on modern society, rose in revolt against the slavery of machinery and destroyed every machine, notwithstanding that at first the country was plunged in the utmost misery. "How many men at this hour," said the Erewhonian leader of this revolution, "are living in a state of bondage to the machines? How many spend their whole lives, from the cradle to the grave, in tending them by night and day? Is it not plain that the machines are gaining ground upon us when we reflect on the increasing number of those who are bound to them as slaves and of those who devote their whole souls to the advancement of the mechanical kingdom." Since Butler's day the point of this satire has grown greater and not less. "The swift stride of civilization," says another writer, "is leaving behind individual effort and turning man into the Dæmon of a machine. To and fro in front of the long loom, lifting a lever at either end, paces he, who once with painstaking intelligence drove the shuttle. *Then* he tasted the joys of completed work, that which his eye had looked upon and his hands handled; now his work is as little finished as the web of Penelope. Once the reaper grasped the golden corn stems and with dexterous sweep of sickle set free the treasure of the earth. Once the creatures of the field were known to him, and his eye caught the flare of scarlet and blue as the frail poppies and sturdy corncockles laid down their beauty at his feet; now he sits serene on the Juggernaut car, its guiding Dæmon, and the field is silent to him."

No one, indeed, can yet say to what end our mechanical civilization is leading, whether to success or to revolt and failure. But we have allowed the increased facility of wealth-production to result in the birth and existence of hundreds of millions more men and women, and we must either continue to toil to produce the wealth with which to sustain them or follow Russia and establish a new equilibrium by starvation and death.

It may be urged that the problem is not an economic but a psychological one. If we can find some other industrial system which appeals with more force to the better instincts of man and develops all his faculties, it may be that his greater contentment of soul will solve our economic difficulties and

that the wealth he will produce will be much greater. If we can only associate more than we do now both his self-interest and his intelligence with his work, if he can feel that the work on which he is engaged most of his earthly life has some meaning for him and that he is not simply another machine added to all those he uses, then he will labour far harder, because with far greater goodwill.

All this and more is true. The manual worker, the brain worker, and the saver of capital, or, in other words, the shareholder, are all necessary to modern industry. They must all receive their due reward, and all share in the responsibility for the industry in and by which they live. The harmonization of their interests to a greater extent than now is a work of great difficulty and complexity, which in all probability can only slowly be worked out. It cannot be solved by any crude system of making us all slaves to a bureaucratic State. Nor can it be solved at all if each section is inspired by brutal class-selfishness and materialism. Those who realize the enormous complexity of the economic problems involved and the impossibility of securing ideal justice and equality or anything like it in this world, cannot but be convinced ever more deeply that far more important than anything else is the spirit in which these questions are approached by each party. If we love our neighbour as ourselves, we can co-operate with him in finding a better way; if we start by hating him we certainly cannot. The highest teachings of religion and their application to practical life are the cement of society. The loosening and cracking of this cement is the most potent modern influence towards social and even economic demoralization.

Meanwhile it is necessary to insist on the economic facts in order to show that disaster will overtake us all if, through impatience or class-selfishness, we try a short cut by destroying what already exists and not by the slower method of amending and improving. Our complicated machine is easily destroyed, or, at least, put out of gear, and unless we keep it running at full speed we shall soon face economic ruin.

But the war with its effects—intolerance on one side, profiteering on the other—has not brought with it a spirit of moderation. The most depressing aspect of to-day's situation is to watch

sections of the working population, misled by the fallacies of their extremist leaders, deliberately committing suicide. While every one will suffer, it is *they* who will suffer most by our diminished national income. Wages can only be paid out of production, and the small margin of safety we possess is day by day being reduced. Labour is day by day working to depress its own standard of life, and, unless our course is quickly changed, no power on earth can prevent it. The root of the trouble is very deep. It lies in the repudiation by many of the whole existing economic system. In their revolt against it they claim that manual labour and skill are the only elements in production, and they demand the elimination of private capital and capitalists. They ignore the fact that saving is a vital factor in production, and that individual initiative, boldness and skill in enterprise, inventiveness, organization and the taking of risks are also all-important and that without them pure manual labour is of little account.

Hitherto profits have been the reward and losses the penalty of enterprise and risk. "Nations are made or unmade," says Mr. Samuel Turner in his stimulating book *From War to Work*, "by the thinking and the acting of their citizens; and what matters most of all is the thinking, for the acting follows upon it. Russia and Siberia have, probably, far greater natural resources and far greater potential wealth than America; but because their peoples have thought and acted in a certain way, the history of their national development has been disappointing. America is America simply because her citizens have thought and acted with wisdom, shrewdness, and energy." Again, "the Ford factory," as he points out, "in Detroit employs immigrants very largely, many, many thousands of them. These men are of various nationalities—Poles, Letts, Slavs, Italians, etc.—and it is probably true to say that in their native surroundings they never earned more than a shilling or two at the outside a day. Yet thousands of these men—i.e., 'labour'—who never in their lives earned more than the barest pittance, cross the ocean. They are absorbed in a great industrial organization, where, thanks to the directing ability of a higher intelligence than their own, they are paid, when accepted, twenty shillings a day for eight hours' work. In the land of their

birth their working day would doubtless be from sunrise to sundown." It is the policy of the Labour Party in future to dispense with the incentive of profits either by "nationalization," or "by the steeply-graduated taxation of private income and riches." In this way "it intends to find the new capital which the community needs and for which it will decline to be dependent on the usury-exacting financiers." * The important question, however, which it is not in the power of the Labour, or any other party to determine, is whether capital will in these circumstances be found to exist in an equal amount to now. Profits are a powerful incentive; risks and losses almost a constant feature of new forms of wealth production. It is more than doubtful if with that incentive gone we shall produce as much, and, as the figures just quoted show, we have none too much already.

As to saving, it is a profound error of labour to regard capital as its enemy and saving therefore as harmful. If capital is the enemy of labour, surely it is strange that, as Mr. Turner points out, "at all times the migration of labour, nationally and internationally, has been towards those areas where, for the time being, the operations of capitalists were most active." Some aspects of the capitalistic system may be intolerable, but capital itself is labour's greatest friend. What is imperatively required is that there should be more of it and that it should be better distributed. The remedy for our ills is to be found in the workers becoming capitalists, not by confiscating the property of those who now possess it, but by joining them in owning it. To do this they must have both the will and the power to save. They must understand how vital is saving to themselves and the whole community, and their wages must be sufficient to allow them a margin for saving. But since wages are paid out of production, production must be increased.

Meanwhile saving is seriously discouraged by present tendencies and by labour's tendency to demand that the State shall be the only capitalist. The man who has grown rich, not at any one else's expense, but by extracting fresh wealth from Nature through his own enterprise, initiative and courage; the shareholder, small and great, all who by saving

* *Labour and the New Social Order*, January 1, 1918.

have added to the national income and labour's share in it, all are treated by the more extreme Socialists as parasites upon society. If these doctrines are pursued to their logical conclusion, the end must be disaster. It is only because in the United States there is more capital that labour is more highly remunerated there. The less capital, the higher the price to be paid for it, the less share of labour in the total product, and the greater the unemployment. Interest, which must be paid on savings if there are to be any, is going up rapidly as the demand grows greater and the supply less. "Nationalization" can do nothing to prevent this. If capital is scarce it must be paid for more highly. Just as labour, if it is scarce, will receive a higher wage. It does not matter whether interest is paid by the State or by a private company. The State must borrow at the market rate unless it is able to make such great profits out of the consumer that it can meet all capital charges out of them, or unless it can institute some system of compelling its employees to save a portion of their salaries and wages and lend them to it below the market rate.

Mr. Smillie and his friends would soon understand the vital part played by saving in a nation's economy if the Miners' Federation were to take over the coal mines. For if the mines are to become efficient they must have many millions spent on them. Who is going to provide the millions, unless for the market price, including interest on capital and a return for the risks run? If Mr. Smillie cannot get them elsewhere, he will have no choice but to let the mines run down or to force the miners to save the necessary sums. *Saving* by some one there must be. And those who save must be induced to do so by some reward for their abstinence and risk. Interest and profits in some form must be paid them.

The trouble, indeed, about British industry before the war was that just as wages were too low, so profits were often not great enough as compared with the profits of industry in many countries abroad. In other words, production was lower, often, no doubt, owing to less favourable conditions. There was a very distinct tendency on the part of British capital to be exported to foreign countries, where profits were greater. British industry, in fact, must be made more efficient and so

enabled to pay higher wages and sufficient profits. The hopeful side of the great increase in wages and costs is that they may force British industry to show far greater efficiency, to work on a larger scale, to eliminate waste, and to apply more labour-saving devices. Low wages have in the past led the British employer to think far too much of the cheapness of labour and far too little of the efficiency of his organization. There is no doubt whatever that we were fast falling behind in the modern race. If we could all pull together there is no reason why we should not quickly reconquer our old position in the world. Our productive capacity is unimpaired, the demands for our products great. We require merely skill, intelligence, energy and goodwill. If, however, false ways of thinking impair our productive capacity, our future must be uncertain.

At present, however, we have to face the fact that, however our national income is divided, there is not in reality enough to go round. You cannot make something out of nothing. If the miners get 6*s*. more in wages and do not produce 6*s*. more wealth, then, unless profits can be reduced sufficiently to provide the sum required—which is not the case—the rest of the community will get 6*s*. less, since prices are bound to rise to that extent. If every one in every industry gets 6*s*. more, then prices will go up by 6*s*. all round, and every one will be where they were before. That is indeed much what has happened. There is no remedy to be found merely by raising wages without increasing production.

On the other hand, the very fact that the national income, even if equally divided, is not sufficient for bare needs, is proof of the criminal wastefulness of luxurious expenditure by the rich. The more their money is spent on wasteful and unproductive luxury, the less is saved and invested in productive industry for the purpose of meeting the needs of the nation, and particularly the working population.

II

Dr. Bowley's figures quoted above refer to the period just before the war. Unfortunately, since then we have become

considerably poorer. Both the country and the Government are now and have for five years been living far beyond their means; our prosperity in war time and now has been and is due to the fact that both country and Government have been living on borrowed money. When, as they must soon do, they cut their coat according to their cloth, we shall feel like a spendthrift who can no longer borrow, and who must depend in future on his own exertions.

Take first the country. In the first six months of 1919, as the Board of Trade figures show, we imported goods to the value of £326,000,000 more than we exported, or at the rate of £650,000,000 per annum. Before the war we earned by freights, interest and commission perhaps between £300,000,000 and £400,000,000 a year to offset our excess of imports and our export of capital. No estimate of what this figure is now is possible, but our interest earnings must have been largely reduced by our great sales of foreign investments. On the other hand, freights are very greatly up. Whatever the resultant figure, as the exchanges show, we are importing far beyond our means. We have found this method of importing on credit so simple in the last two or three years, owing to the fortunate entry of the United States into the war, that few people realize that, had the United States not come in, the Allies could not after the middle of 1917 have continued the war on anything like the same scale as before. We alone have borrowed from the United States since March, 1917, nearly £1,000,000,000. But that process has now come to an end, though many of our imports still being shipped may have already been paid for in borrowed money. But soon we must pay with our own money—i.e., our exports, our freight, and so forth—for all we buy, and it is only then that we shall feel the full force of the new conditions.

It is important our people should understand that other countries do not send us goods free for love of us. They want payment, and can only get it by buying products from us—e.g., coal, wool or manufactured goods. This means of payment they cannot now get, or only with difficulty, and therefore we shall soon find it difficult to import on anything like the same scale as now, notwithstanding that in general our imports are vital to our welfare. Moreover, all we import will cost us

more; for the more the balance of trade goes against us, the more unfavourable become our exchanges and the less is the value of a pound sterling in terms of a dollar or a rupee. Already everything from the United States is costing us about 12 per cent more than normal owing to the fall in the exchange, and, as it is likely to fall still more, this burden will probably increase. Imports from India cost about 37½ per cent more than before the war. Prices will advance equivalently here on articles so imported, and, as many of them are essential raw materials for our industry, the handicap we are imposing on ourselves is obvious. At a certain level the United States in their own interest may, and probably will, give us credit in a larger or smaller degree, since they will want to get rid of their exports. But borrowing is merely a palliative, not a remedy. We may by borrowing give ourselves a little more time to establish our balance, but meanwhile we shall fall still deeper into debt. It is imperative, therefore, that we should increase our exports, and particularly to those countries from whom we can get imports.

As long as the country lives beyond its means, we are in a vicious circle. The depreciation of the exchanges increases the cost of imports; prices accordingly rise, and the higher internal prices encourage further imports and discourage exports. It is only when we cannot go on living beyond our means—i.e., when the prices of imports become prohibitive by the fall in the value of our own currency and, on the other hand, exports are artificially stimulated by the increase in the relative value of foreign currencies—that the tide begins to turn. But such a process will involve a heavy strain and readjustment on so highly developed a foreign trade as ours, and we shall return to a healthy state only at great cost to ourselves.

It is probable that sanity as regards purchases abroad will be more or less imposed on us. Borrowing, whether abroad or at home, appears to most people to have been during the war a wonderfully successful scheme, a kind of invention in the economic world, which has somehow shown we were much richer than any one ever thought. But perpetual borrowing is no easier to invent than perpetual motion. For, fortunately or unfortunately, the perpetual lender has not yet been discovered.

Our borrowing abroad at any rate is likely to be strictly limited. America and other countries will, no doubt, lend to some extent. But all Europe requires credit, and America's credit resources will be greatly taxed to provide for nations more destitute than we are.

Our problem is indeed a difficult one. For our own sakes and for the world's we must help Europe to mend its broken economic life. We must trade with it, because we must sell our goods. Yet we cannot trade except on credit, since Europe has, broadly, no means of paying. How can we give credit, with our enormous adverse balance of trade, and when we too must borrow? Must we not sell our exports only to those countries who can pay us in immediate imports? If we use our labour and capital to provide exports to an impoverished Europe, which must owe us for them, is not our power to purchase our own imports *pro tanto* reduced? There is no wholly satisfactory answer to these questions. Strictly speaking, we cannot afford to give credit. On the other hand, to some extent we must. It is an impossible policy to refuse to trade with Europe at all. We must ourselves rely, in our turn, on getting credit elsewhere. The crisis is too great and urgent. Most of Europe is in desperate need. Unless its industries get started the very gravest social disorders and even social collapse seem probable, and the reaction on ourselves would be profound. The rapidity, too, of our recovery depends on that of Europe. We must all go forward more or less together. It may be argued, if we refuse help, America, with her vastly favourable balance of trade, can and should give it. But, while she will give credit to sell *her own* goods, will she lend to sell *ours*? She would be wise and far-sighted to do so, but it is doubtful if she will. But while giving and taking credit to such a minimum extent as will be found inevitable, we must face the fact that lending and borrowing are merely temporary expedients. What is vital for the impoverished countries of Europe, including our own, is to work hard and live hard until they can pay their own way.

The problem would be rendered more easy for us if all countries exporting raw materials, especially the British Dominions, would themselves provide the necessary credit for financing

their own exports, instead of looking to the overburdened British people to do so.

If our borrowing is, as it should be, reduced to a minimum, then we must allow economic conditions full play and let the exchanges fall to the point which our situation justifies, and which, at whatever cost in higher prices to ourselves, will compel us one and all to live as our circumstances demand.

But it is not only the country but the Government, too, that has been living for five years beyond its means. It is the vast internal borrowing by the Governments of all belligerent countries, with the consequent inflation of currency and credit, from Vladivostok right round the world to San Francisco and Vancouver, that has led in the main to the vast increase in world prices. This increase will continue as long as Governments borrow large sums by means which add to the floating amount of money and credit. Here, again, we are in a vicious circle. Every increase in prices at present means more Government borrowing, and Government borrowing again increases prices. There is only one remedy. Revenue and expenditure must balance. We all sympathize with the great schemes of social betterment, involving vast and often productive outlay on the Government's part. Nevertheless, if, as seems likely, we have almost reached the limit of productive taxation, the first duty of a statesman is to see that expenditure does not exceed the revenue he can raise. A capital levy is not an alternative. It must not be used for revenue purposes, but only to pay off capital debts. It would, no doubt, reduce interest charges, and so allow of some reduction in taxation. But it would be a fatal and spendthrift policy to use it for meeting recurring expenditure.

Similarly, it is a ruinous policy to use taxation to pay subsidies on coal, bread and railways. Every industry must stand on its own feet. Otherwise we shall end in the most hopeless confusion. For this reason Sir Auckland Geddes's imposition of 6*s.* on coal is to be heartily welcomed, and it is to be hoped the railway, bread, and any other subsidies will be dealt with also. Anything is better than "make believe." To do away with subsidies will increase prices. But we shall at least have some chance of getting on to a sound basis. To main-

tain them would also increase prices by increasing Government borrowings, as well as prolong a rotten economic situation. So long as prices *ought* to be high, to correspond with the increased inflation, it is useless to try and dam the flood. A French authority recently informed the writer that the French Food Administration determined to provide cheap food for the workers. At Marseilles, for instance, a déjeuner of 1½ francs was provided. It was found, however, that the result was that the workmen merely bought wine for 5 francs and cigars for 2 francs. They had plenty of paper money, and they were going to spend it somehow.

This problem of internal borrowing is, if anything, more dangerous than external. We cannot borrow abroad if no one will lend. But, even if we refuse to subscribe to our own Government loans, a reckless Government has still one expedient fatal but simple. It can take our money from us without our knowing it by issuing more currency notes. Before the war no Government had such power. But since we have abandoned the gold standard there is no further legislative hindrance to unlimited depreciation. As the currency increased, prices would go up and up. No price regulation would be of any avail, nor any other method of stopping profiteering. While prices are rising, profiteering is automatic. To follow this line, therefore, would be suicidal. But in a tight corner politicians do suicidal things and very many Governments in history have fallen to the temptation, and indeed are falling now.

Suppose, however, that, whether by choice or compulsion, the Government pursues a sound policy. There would then be hope that we should gradually right ourselves. So far as prices were dependent on our own as apart from world conditions, they would tend to remain stationary or gradually to fall. Falling prices bring, as is well known, depression in industry. Production slackens in order to readjust itself to consumption. Profits disappear. Businesses with heavy commitments get into difficulties. No one wishes to extend. Unemployment increases, and wages are extremely difficult to keep up. In fact, it is a period of unpleasant convalescence after fever. It has to be gone through, though it is wise to see that the high temperature does not fall too rapidly, since

a general collapse of prices is to be avoided by all possible means. We have to brace ourselves to go through such a period. If we face facts, we may get over our difficulties more easily than seems now likely.

But suppose, on the other hand, that the Government does not economize and continues to borrow. Suppose, further, that production and exports continue at a low ebb. Then prices will probably rise very rapidly. The cost of imports, through the declining exchanges, will become so exorbitant that we shall hardly be able to purchase either food or raw materials for industry, and the very high prices due to this and to further inflation of currency and credit will both check consumption here and render competition abroad more difficult, apart altogether from growing social disturbance. Luckily for us, prices abroad are very high, often much higher than ours. But clearly such conditions have great dangers. When prices stop rising, many companies will experience great difficulties. A constant adjustment between supply and demand, consumption and production, is at all times necessary, and in times of such violent fluctuations a sufficiently rapid adjustment becomes more and more difficult. Moreover, a thoroughly unhealthy condition of affairs, of which we see many traces now, is brought into being. The normal consumption of all those who are not in a position to increase their incomes falls off in face of the constantly rising prices ; the working population is affected similarly unless it can secure a continuously increasing remuneration ; on the other hand, profits in many trades and businesses are, or at any rate appear, enormous. "Easy come, easy go," and all the class of profiteers, whether from the ranks of capital or labour, spend much on wasteful extravagance. Ultimately, however, the check in consumption, due to the excessive cost of imports, must tell. The necessary readjustment of production to consumption will not be made rapidly enough. Over-production in some line or other will prove exceptionally dangerous to industrial companies loaded with stocks bought at very high prices. If there were to be a general collapse of prices, there would be widespread failure and distress. What is more likely is that conditions would be sufficiently stable to enable the readjustment and fall in prices

to be made gradually over a more or less lengthy period of depression.

There is perhaps no country in the world which stands to suffer more than England from very severely depreciated exchanges. In countries where internal production from the soil can be rapidly increased, or where industry either is not highly developed or can find its raw materials within the country's borders, depreciated exchanges can bring a rapid reduction of imports and increase of exports without a very great internal strain. But our state is different. The bulk of our imports—i.e., food and raw material—we must have. We cannot export without them. The production of our own soil, whether in food or raw materials, cannot be rapidly increased. The situation is therefore very difficult. Let us repeat that it requires imperatively that prices should not continue to rise. They will certainly rise, whatever may be the measures against profiteering, unless economy on the part of the Government allows a halt to be called to further inflation and unless by increased production we can largely increase our exports. It is not profiteering—bad as that is—that is the greatest cause of high prices, but that condition of affairs in which profiteering is bound, by the very nature of things, to flourish. For an extravagant Government to pass Profiteering Acts is merely for Satan to rebuke sin.

III

Those who think it is easy to exaggerate the seriousness of the present position are advised to study Mr. Hoover's Memorandum on the economic situation of Europe, published by the Ministry of Food since the above pages were written. For the purpose of convenience this striking statement is printed at the end of this article, since there is no living man who has a tithe of Mr. Hoover's knowledge and experience in this matter. Europe is in a plight which few in this country suspect. Whilst our difficulties are great, they are small compared with those of our neighbours.

Mr. Hoover endorses in a far more striking way all that has been said above with regard to the necessity of increased

production, of saving, and of Government economy. It is particularly interesting to note the strong opinion which he expresses against any attempt to tamper by Government action with "the delicate and highly developed organization of production and distribution," or to try to remedy our difficulties by the control of prices whether national or international.

There is no one concerned with Government price-fixing during the war, and the extraordinary complications and perplexities produced thereby, who would not echo his words. All-important is his statement that the control of prices and distribution cannot stop with a few prime commodities, but must go on, until they have all been placed under restriction "with inevitable stifling of the total production." Whilst Mr. Hoover with his unrivalled experience says this, our Government has introduced a Profiteering Bill which may do good in some directions, but may easily do more harm in others. Mr. Lloyd George should remember that he once said in a famous speech that you "cannot haggle with an earthquake."

There is no sovereign remedy for our existing ills. They are the natural and inevitable consequence of the war. They arise partly from the destruction of wealth, partly from the inflation of currency and credit, partly from the interference of Governments, necessary during the war, with the normal course of supply and demand, and very largely from the enormous dislocation of world industry in every direction. All these influences are at work in raising prices. So far as our industry is affected by conditions in other countries, we can merely wait till they commence to recover. That depends partly on the wisdom of the Governments concerned, but far more on the energy and initiative, hard work and hard living of the people of each country. While, however, our neighbours' troubles will bring us troubles too, these can be enormously diminished or aggravated by our own action. The Government's duty is clear. It must bring its expenditure within the limits of its revenue, cease borrowing except for redemption of short-dated loans and stop inflating credit and currency. If it has not the courage to adhere firmly to such a policy, our situation must infallibly grow worse. It will require great courage. All sorts of schemes, which ought for other reasons to be carried out,

must be abandoned, and one criterion alone established: "Can we afford it?" not "Is it an attractive and desirable scheme?" A man would often like to spend much more than he does for the benefit of his family, but, if he is not rich enough, he cannot. So with a nation. A large part of the population believe still that the war either will or at least ought to bring great improvements in conditions. They look for some new thing, for a new England where every one will be better off than before, and they regard very naturally drastic State action as the main means of achieving this end. The State is either to "nationalize" this or that industry or it is to spend vast sums on housing, forestry, railways, canals and a hundred and one laudable objects. It is to find the means by raising great sums from the rich, voluntarily, if possible, or if not, by compulsion. It is to secure to itself all profits, or, if necessary, to confiscate a good part of existing wealth.

Such a programme is not feasible. If a capital levy is resorted to, the proceeds must be devoted to reducing existing indebtedness, not to meet further expenditure. It is hardly possible to increase taxation on profits or any other source without diminishing the yield. There is, it is true, urgent need for large expenditure in many directions. But there is no benefit Government expenditure can give commensurate with the evils of further inflation and further rises in prices. Nationalization or State Socialism in any form, looked at from the economic standpoint, must be judged in the long run according as to whether it will ultimately increase our national income—i.e., result in the production of more wealth with less effort.

For the immediate present it must be judged according as to whether it involves further Government expenditure. If it does, existing conditions forbid us in the interest of every class of the community to enter upon it.

Until economy is the watchword of the Government in power, it is useless to consider currency or any other reform. If once it is certain we have reached stability in Government expenditure, the way will be cleared for grappling with our other problems. Confidence will begin to return; industry will be able to make plans for the future, and reform of the currency can be taken in hand. If, however, we are deceived by the

appearance of prosperity into thinking we can still afford all kinds of experiments, we shall invite the gravest economic and financial disorder.

The Economic Situation in Europe

Statement and Analysis by Mr. Herbert Hoover.

I

The economic difficulties of Europe as a whole at the signature of Peace may be almost summarized in the phrase "demoralized productivity." The production of necessaries for this 450,000,000 population (including Russia) has never been at so low an ebb as at this day.

A summary of the unemployment bureaux in Europe will show that 15,000,000 families are receiving unemployment allowances in one form or another, and are, in the main, being paid by constant inflation of currency. A rough estimate would indicate that the population of Europe is at least 100,000,000 greater than can be supported without imports, and must live by the production and distribution of exports; and their situation is aggravated not only by lack of raw materials, imports, but by low production of European raw materials. Due to the same low production, Europe is to-day importing vast quantities of certain commodities which she formerly produced for herself and can again produce. Generally in production, she is not only far below even the level of the time of the signing of the Armistice, but far below the maintenance of life and health without an unparalleled rate of import.

Even prior to the war these populations managed to produce from year to year but a trifling margin of commodities over necessary consumption, or to exchange for deficient commodities from abroad. It is true that in pre-war times Europe managed to maintain armies and navies, together with a comparatively small class of non-producers, and to gain slowly in physical improvements and investment abroad; but these luxuries and accumulations were only at the cost of a dan-

gerously low standard of living to a very large number. The productivity of Europe in pre-war times had behind it the intensive stimulus of individualism and of a high state of economic discipline, and the density of population at all times responded closely to the resulting volume of production.

During the war the intensive organization of economy in consumption, the patriotic stimulus to exertion, and the addition of women to productive labour largely balanced the diversion of man-power to war and munitions. These impulses have been lost.

II

It is not necessary to review at length the causes of this decrease of productivity. They are, in the main, as follows :—

The industrial and commercial demoralization arising originally out of the war, but continued out of the struggle for political rearrangements during the Armistice, the creation of new Governments, their inexperience, and friction between these Governments in the readjustment of economic relations.

The proper and insistent demand of labour for higher standards of living and a voice in administration of their effort has unfortunately become impregnated with the theory that the limitation of effort below physical necessity will increase the total employment or improve their condition.

There is a great relaxation of effort as the reflex of physical exhaustion of large sections of the population from privation and from the mental and physical strain of the war.

To a minor degree, considering the whole volume, there has been a destruction of equipment and tools, and loss of organization and skill, due to war diversions, with a loss of man-power. This latter is not at present pertinent in the face of present unemployment.

(The demoralization in production of coal. Europe to-day is an example in point of all these three forces mentioned above, and promises a coal famine with industrial disaster unless remedied. It is due in a small

percentage—from the destruction of man-power—to the physical limitation of coal mines or their equipment. It is due in the largest degree to the human factor of the limitation of effort.)

The continuation of the Blockade after the Armistice has undoubtedly destroyed enterprise even in open countries, and, of course, prevented any recovery in enemy countries. The shortage in overseas transportation, and the result of uncertainties of the Armistice upon international credits have checked the flow of raw materials and prevented recovery in the production of commodities especially needed for exchange for imports from overseas. The result of this delay has been unemployment, stagnation, absorption of capital in consumable commodities to some extent all over Europe.

From all these causes, accumulated to different intensity in different localities, there is the essential fact that, *unless productivity can be rapidly increased, there can be nothing but political, moral and economic chaos, finally interpreting itself in loss of life on a scale hitherto undreamed of.*

III

Coincident with this demoralization in production, other disastrous economic phenomena have developed themselves, the principal one of which is that the very large wages paid to special workers, and the large sums accumulated by speculation and manufacture during the war, have raised the standard of living in many individuals from the level of mere necessities to a high level of luxuries. Beyond this class there is a reflex in many other classes from the strenuous economies against waste and the consumption of non-essentials in all countries; and, as a result, there is to-day an outbreak of extravagance to a disheartening degree.

Another economic change, of favourable nature from a human point of view, but intensifying the problems of the moment, has been the rise in the standard of living in large sections of the working classes through the larger and better wage distribution, separation allowances, etc., during the war.

Parallel with these classes are those of fixed income, the unorganized workers, and the unemployed, on whom the rising cost of living is inflicting the greatest hardship.

IV

During some short period it may be possible for the Western hemisphere, which has retained and even increased its productivity, to supply the deficiencies of Europe. Such deficiencies would have to be supplied in large degree upon credits. But aside from this, *the entire surplus productivity of the Western hemisphere is totally incapable of meeting the present deficiency in European production if it is long continued. Nor, as a practical fact, could credits be mobilized for this purpose for more than a short period, because all credits must necessarily be simply an advance against the return of commodities in exchange, and credits will break down the instant that the return of commodities becomes improbable. Further, if such credits be obtained for more than temporary purposes, it would result in economic slavery of Europe to the Western hemisphere, and the ultimate end would be war again.*

The solution, therefore, of the problem, except in purely temporary aspects, does not lie in a stream of commodities on credit from the Western hemisphere, but lies in a vigorous realization of the actual situation in each country of Europe and a resolute statesmanship based on such a realization. The populations of Europe must be brought to a realization that productivity must be instantly increased.

V

The outcome of social ferment and class consciousness is the most difficult of problems to solve. Growing out of the yearning for relief from the misery imposed by the war, and out of the sharp contrasts in degree of class suffering, especially in defeated countries, the demand for economic change in the status of labour has received a great stimulus leading to violence and revolution in large areas, and a great impulse to radicalism in all others. In the main, these movements have

not infected the agricultural classes, but are essentially a town phenomenon.

In this ferment Socialism or Communism has claimed to speak for all the downtrodden, to alone bespeak human sympathy and to alone present remedies—to be the lone voice of Liberalism. Every economic patent medicine has flocked under this banner. Europe is full of noisy denunciation of private property as necessarily being exploitation. Considerable reliance upon some degree of Communism has been embraced by industrial labour even in non-revolutionary countries. Its extremists are loud in assertion that production can be maintained by the impulse of altruism alone, instead of self-interest. Too often they are embracing criminal support and criminal methods to enforce their ideals of human betterment. Every country is engaged in political experimentation with varying degrees of these hypotheses, and so far every trial has reduced production.

The Western hemisphere, with its more equitable division of property, its wider equality of opportunity, still believes that productivity rests on the stimulus from all the immutable human qualities of selfishness, self-interest, altruism, intelligence with education. It still believes that the remedy of economic wrong lies not in tampering with the delicate and highly-developed organization of production and distribution but in a better division of the profits arising from them. It still believes in the constitutional solution of these problems by the will of the majority, while Europe is drifting toward the domination of extremist minorities. The Western hemisphere's productivity is being maintained at a surplus over its own needs.

The first and cardinal effort of European statesmanship must be to secure the materials and tools to labour, and to secure its return to work. They must also secure a recognition of the fact that, whatever the economic theory or political cry, it must embrace the maximum individual effort; for there is no margin of surplus productivity in Europe to risk revolutionary experimentation.

No economic policy will bring food to those stomachs or fuel to those hearths that does not secure the maximum production.

There is no use of tears over rising prices ; they are, to a great degree, a visualization of insufficient production.

VI

During the period of reconstruction and recovery from reduced productivity conservation in the consumption of non-essential commodities is more critical than at any time during the war. The relaxation of restriction on imports and on consumption of articles of this character since the Armistice is disheartening in outlook. It finds its indication in the increased consumption of beverages and *articles de luxe* in many countries, even above a pre-war normal.

Never has there been such a necessity for the curtailment of luxury as exists to-day.

VII

The universal practice, in all the countries at war, of raising funds by inflation of currency is now bringing home its burden of trouble, and in extreme cases the most resolute action must be taken, and at once. In other countries of even the lesser degree of inflation such currency must be reduced and included in the funded debt, or alternatively the price of wages, living, and international exchange must be expected to adjust itself to this depression. The outcry against the high cost of living, the constant increase of wages and the fall in exchange that is going on are in a considerable degree due to this inevitable readjustment.

VIII

The stimulation of production lies in the path of avoidance of all limitations of the reward to the actual producer. In other words, attempts to control prices (otherwise than in the sense of control of vicious speculation) are the negation of stimulation to production, and can only result in further curtailment of the total of commodities available for the total number of human beings to be fed, clothed, and housed.

There still exist in Europe great bureaucracies created from the necessity of control of price and distribution by the conditions of the war, who are loth to recognize that with world markets open no such acute situation exists, and that their continued existence is not essential except in the control of speculation. The argument so much advanced that world shortage may develop, and justifies continued control of distribution and price, is based upon the fallacious assumption that, even if the world markets are freed of restraint, there is a shortage to-day in any commodity so profound as to endanger health and life.

From any present evidence, thanks to the high production outside Europe, no shortage exists that will not find its quick remedy in diminished consumption or substitution of other commodities, through minor alteration and price. All attempts at international control of price, with a view to benefit the population in Europe at the cost of the producer elsewhere, will inevitably produce retrogression in production abroad, the impact of which will be felt in Europe more than elsewhere. A decrease of 20 per cent of Western hemisphere wheat would not starve the West; it would starve Europe.

It must never be overlooked that control of price and distribution cannot stop with a few prime commodities, but, once started, its repercussions drive into a succeeding chain of commodities; and that on the downward road of price control there can be no stoppage until all commodities have been placed under restriction, with inevitable stifling of the total production.

It is also often overlooked by the advocates of price control that, whereas the high level of production was maintained during the war even under a restraint of price, this high production was obtained by the most vivid appeal to patriotic impulse on both sides of the front. This stimulus to production and distribution no longer obtains, and the world must go back to the prime impulse—and that is the regard to the individual producer and distributor.

That body of advocates who have deduced from war phenomena that production and distribution can be increased and maintained by appealing to altruism as the equivalent of

patriotism or self-interest should observe the phenomena of Russia, where the greatest food-exporting country is to-day starving.

IX

It must be evident that the production cannot increase if political incompetence continues in blockade, embargoes, censorship, mobilization, large armies, navies and war.

X

There are certain foundations of industry in Europe that, no matter what the national or personal ownership or control may be, yet partake of the nature of public utilities in which other nations have a moral right. For instance, the discriminatory control of ships, railways, waterways, coal and iron in such a manner as to prevent the resumption of production by other States will inevitably debar economic recuperation and lead to local spats of economic chaos with its ultimate infection abroad, to say nothing of the decrease in productivity. These misuses are already too evident.

XI

The question of assistance from the Western hemisphere during a certain temporary period, and the devotion of its limited surplus productivity to Europe, is a matter of importance and one that requires statesmanlike handling and vision. It is but a minor question compared to those stated above, and it is in a great degree dependent upon the proper solution of the factors already touched upon.

It is a service that the Western hemisphere must approach with a high sense of human duty and sympathy. This sense will, however, be best performed by the insistence that its aid would not be forthcoming to any country that did not resolutely set in order its internal financial and political situations, that did not devote itself to the increase of productivity, that did not curtail consumption of luxuries and the expenditure upon armaments, and did not cease hostilities, and did not treat its neighbours fairly.

If these conditions were complied with, it is the duty of the West to put forth every possible effort to tide Europe over this period of temporary economic difficulties. Without the fulfilment of these conditions, the effort is hopeless.

With Europe turned towards peace, with her skill and labour aligned to overcome the terrible accumulation of difficulty, the economic burden upon the West should not last over a year, and can be carried, and will be repaid. To effect these results the resources of the Western hemisphere and of Europe must be mobilized.

HERBERT HOOVER.

July 3, 1919.

X

INTERNATIONAL FINANCIAL CO-OPERATION

(March, 1920)

In a general way every one is aware of the very grave—many think desperate—economic and financial state of Europe. The disastrous effects of so prolonged and exhausting a war, which were largely hidden from the people of this country, at any rate in the course of the struggle itself, are now gradually making themselves manifest; and the end is not yet, for the complications of this universal after-war economic disease have by no means reached their crisis. Meanwhile our comparative comfort in this country in no small degree blinds us to the suffering and privation which are so widespread on the Continent; and trade at home and to other continents is good enough to make our manufacturers feel somewhat independent of the necessity to export to Europe. Nevertheless, the financial and economic crisis will continue to render the European horizon darker and darker, and it is our duty to ask whether there is any remedy to Europe's ills, or even any palliative, in the form of some closer and more active international co-operation than hitherto. It is a very common supposition that an ample supply of international credit is the proper remedy. In the present article this supposition will be examined, and for the purpose of putting it in its proper setting and proportion it is necessary to take rather a wide view, and perhaps give expression to what may seem a good many platitudes.

Broadly speaking, the war has produced in all countries—certainly in all belligerent countries—the same economic effects, and we find, therefore, that, with local variations

and with greater or less intensity, similar troubles affect all European nations. Their causes may roughly be classified as economic, political and psychological.

The economic causes are sufficiently obvious, and only a few of them need be briefly mentioned. The vast loss of European capital, both fixed and circulating, is one of the most serious evils. The results are felt most acutely in the very serious depreciation of means of transportation, in lack of houses, in a great dearth of raw materials and stocks of all kind, particularly of coal. It is important to note that whatever foreign credit is provided, the replacement of this capital is at best a matter of time. It will be some time, for instance, before the railways, ports and other means of transportation can recover their efficiency.

In the second place, the enormous financial demands of the war have entirely overstrained the currency systems of Europe. In the case of some countries currency depreciation is mainly due to the internal requirements of the Government, which have been satisfied by the printing of vast quantities of paper money; in other cases a powerful contributory factor has been the vast excess of imports over exports, leading to a depreciation of the exchanges. But whatever the immediate cause, there can be no doubt that the chaos of European currencies is by far the most menacing symptom of the present day. The constant depreciation, the constant fluctuation of the standard of value, renders all industry and trade mere speculation, drives us back, first in international and then in internal transactions, to the primitive method of barter, and renders impossible the highly complex and delicate financial and industrial system of pre-war days. If these conditions are allowed to develop, the population of Europe, brought into being in such huge numbers in the last forty years by the intensive development of modern means of wealth-production, is bound to suffer not merely a serious deterioration in the standard of living, but actually a considerable diminution in numbers, in order to restore the equilibrium between population and production. It is unnecessary, however, to develop all the grave consequences of currency depreciation. Its effect, if it is continued far enough, must be almost to disintegrate a modern highly developed

industrial society, to destroy its past savings, and to reduce it to ruin and despair. To secure some stability of currency conditions is therefore imperative. On the other hand, it is more than doubtful if the time is yet reached when any joint international scheme of reform, which, if the gold standard is to be generally retained, will almost certainly be necessary later, can be undertaken. A stable currency seems impossible for any country whose foreign trade still shows an enormous adverse balance, and whose budget makes no pretence of balancing its receipts and expenditure. To be able to maintain a sound currency a country must pay its way in the world. Therefore, from the point of view of currency, as of everything else, the productive process must first be set going again. Just as serious currency depreciation diminishes production, both industrial and agricultural, so a restoration or an increase of production is the only foundation for a return to sound currency, as indeed it is the foundation of taxation. We must deal first with the basic problem of restoring the cycle of production and exchange, though hand in hand should, of course, go an insistence on proper taxation, on the imperative necessity of the various Governments balancing their budgets, and on some control over the too free creation of credit.

A third economic difficulty facing many of the belligerent countries is that, even if they are ready to export, they have lost their foreign markets; their overseas trade is gone, and others have taken their place. New connections and new trades must be developed, and time is required for this. A supply of credit alone will not bring old markets back.

A fourth cause of troubles, of great importance, is the continuance of Government control over trade and industry —including price fixing, nationalization projects, socialization of industry, and so forth. We know the very serious effects in this country, but they are not less so on the Continent. Many Governments seem to be getting their countries into a most hopeless tangle by keeping prices lower than the depreciation of their currency justifies. They check production, increase Government expenditure, and with it the paper currency, and continue a vicious circle which must ultimately end in disaster. Interference with ordinary economic laws

produces, indeed, the most widespread and unexpected consequences; and whether it is the rent of the houses, the price of coal or of butter, or anything else, almost at any cost we should re-establish freedom. But with present socialistic tendencies in Europe whether we shall do so seems doubtful. Indeed, the probable exchange blockade of Europe may drive us all still more into the arms of Governments again. Huge nationalization projects stand condemned on this ground alone.

Then, again, in the case of our Allies, France and Italy, the very absorption of all their national energies in war has landed them in a serious difficulty, in which we too, in a minor degree, find ourselves. In order that the whole of their man-power and all their industrial forces might be applied to war purposes we kept them in a kind of hot-house atmosphere, and provided them on credit with food and all the other materials they had to have, so that their economic development took a lop-sided form. They came to rely on credit for most of their imports. When these and their war industry both came to a sudden end, they suffered like hot-house plants when the steam heat is turned off. They cannot adjust themselves at once to their new environment. The recovery of equilibrium cannot, indeed, but take some years. Both the people of the United States and we, too, should remember that these countries find themselves in this plight because they were called on for our sakes as well as their own to devote all and more than all their normal economic strength to the war. This argument should have weight in the future consideration both of international indebtedness and of the grant of credit.

If we turn our eyes from economic to political Europe there is nothing to encourage us. Nothing was more depressing to any one who spent some months in Paris during the spring than the complete absence of any generous or even sane outlook on future international relations. The war seemed merely to have intensified tenfold the mutual dislike which existed before. We hated our enemies and, of course, they hated us; most of the Allies seemed to hate one another; above all, the small nations which had just emerged hated one another with an even more bitter intensity. At that time, at any rate, they clamoured for credit in order to buy more high explosives

and machine-guns rather than for the restoration of industry. Was it not folly, one thought, to lend such countries money? They had no capacity or experience for governing, and would certainly waste it. Worse still, what chance was there for currency or any other economic reform when they were spending on armaments and plans for international fratricide far more than they could possibly raise by taxation or by any other means than the printing-press? It is useless to talk of the economic regeneration of Europe in face of this prevailing international hostility and mutual fear. But can we, who should know better, blame them, when we are responsible for the Reparation Chapter of the Peace Treaty?

Lastly, we have to add to the economic and political troubles of Europe the profound psychological disturbance of the war which so seriously affects any rapid economic recovery. Our modern millions are enslaved by the great machine of modern civilization by means of which alone they have been brought into the world, and they can only keep themselves alive by working it. Yet even before the war they were revolting against it, and the ferment of the war has immensely sharpened their hostility. Great as have been abuses of the capitalistic system, it is doubtful whether any other system can free itself from the soulless and monotonous character of modern industrial life, which is at the bottom of nearly all the unrest, and more doubtful still whether it can produce wealth at the same rate. It is ominous, therefore, that at a time when greater saving and greater production are essential to our recuperation, the great mass of workers in all European countries, resenting bitterly the profiteering which inevitably arises from existing conditions, should be dimly contemplating the overthrow of our whole economic structure. So far are they from realizing that their very life depends on working it at full blast, that they believe there exists even now in the world great stores of ready-made wealth which they ought to and can secure if they are only insistent enough and if they can utilize the machinery of the State to extract if from its present owners. In consequence, all over Europe, at a moment when Government expenditure should be reduced to a minimum, clamorous demands for the extension in every sphere of Government

activities are pressed forward. Government expenditure thus bounds up, and, since the limits of taxation and loans are reached, further currency depreciation and a further approach towards the abyss are the result.

Consider some of the results of this weltering economic, political and psychological chaos. Where all three influences, and particularly the psychological, have had the fullest play—namely, in Russia—they have produced more or less complete ruin, notwithstanding that Russia can live for years through chaos which would annihilate such industrial States as England, Belgium or Germany in a few months. Coming further east, we find the same influences reducing Austria to such a position that she is beyond any ordinary help through the provision of credit, and is now merely the recipient of charity. Germany's position appears to get worse, not better. Though her head is still above water, she is farther down the road to ruin than France or Italy. She, too, has reached the point when assistance through ordinary financial and commercial chann ls is becoming more and more difficult, if not impossible. The continued depreciation of her currency is due partly to internal exhaustion, partly to the necessity she is under to meet her maturing obligations abroad and to make at any cost purchases of raw materials and food. She has to sell marks down to any figure to fulfil these two latter requirements. The consequent collapse in her exchange leads to the peculiar position that internally her currency is still of considerably greater value than externally, with the result that absolutely necessary imports by the Government must either be sold at a price too high for the public to pay or that price must be reduced by subsidies which either must break the taxpayer's back or be met by increased paper issues. But, of course, the tendency must be for internal prices to rise further to the level of the exchange, with the necessary result of further inflation. This process cannot continue indefinitely without Germany's currency ultimately losing all value. When once her people have abandoned all confidence in their currency it is difficult to foresee the consequences. As Mr. Hawtrey has recently shown in his able book, France, in a similar position a hundred years ago, imported great quantities of gold to replace the

assignats. But could Germany do that? And if not, what workable alternative has she but to create a new paper standard, which might go the same way as the last? It is not to our interests to let Germany fall into absolute chaos. Whatever we might be able to do, Continental Europe cannot get on without Germany, and her entire collapse would bring disaster to Europe. Her present Government, which we should support if we do not want to see the reactionaries or Bolshevists in power, seems to be doing its best to make both ends meet, and heavy taxation is being imposed. But her credit is too depreciated and her future too uncertain for her primary needs in the way of raw material to be met by ordinary banking credit. The risks are too great both for importers and exporters.

The French and Italian situation is not yet so desperate as the German. Their exchanges have not yet reached anything like so tremendous a depreciation, and there are signs of recovery in their export trade, particularly in Italy's case; but their future is far from rosy. It is quite impossible for them to continue importing on the scale they are doing now. Many people do not recognize that a year ago these countries were able to obtain much more credit than they can to-day. In the last year both London and New York have advanced them very considerable sums through ordinary banking and private channels. The most recent National City Bank circular states that "the present volume of trade can be accounted for only upon the theory that individual credits have been granted upon a larger scale than is generally known," and that "there is much evidence to confirm this opinion." But this cannot continue indefinitely. Most of these credits cannot be paid off, except by renewals of some sort or by raising long loans in foreign countries, the public response to which is doubtful. It will be difficult in these circumstances to secure fresh credits. There seems no alternative, therefore, between an enormous—perhaps impossible—decrease in imports from overseas or a collapse of the exchanges, nor any reason, indeed, why if the situation is left to develop itself the French and Italian situation should not work out in more or less the same way as the German is now doing.

The statistics published by the Supreme Economic Council

show that between January and the end of September, 1919, French imports exceeded exports by £538,000,000, and between January and October, 1919, Italian imports exceeded exports by £390,000,000. Their invisible exports have to be set against these imports, but it is doubtful if they can be very great. There are signs of improvement, but, in the case of France at any rate, they are not very striking. Adverse balances of these dimensions could not, and should not, be corrected by credits. A collapse of the French and Italian, as well as of the German, exchange would, of course, very seriously affect all the smaller nations of Europe as well as ourselves. Our exchange is being depressed now because of European nations meeting their obligations in the United States through London, and, as long as these nations have any sterling they can so use, must continue to be depressed. It is possible that all the big Continental exchanges might well fall to a point at which imports, at any rate from the United States, might become impossible. Yet Mr. Hoover estimates that 100,000,000 Europeans live on imports, which they used to obtain by exchanging their manufactured exports for them. In imagining ourselves the straits to which Europe might be reduced, we should not consider that any comparisons with former ages have much value. The European population have never before been dependent as they are now on the smooth working of the great world-wide industrial and financial machine.

What, then, ought to be done? Can anything much be done? Is there any sign that anything will be done? Should we do well to follow the advice given by Mr. Keynes in his brilliant book, and do nothing till we have got rid as a start of every existing Government in Europe? Or is Sir George Paish right, and should Europe borrow \$7,000,000,000—or was it £7,000,000,000?—from the United States? Is there in reality any firm basis at all yet for international co-operation outside such normal commercial and financial transactions as can still take place? Does not external Government assistance, or even the belief that such assistance is coming, merely breed idleness and want of enterprise? Is there anything much worse than the Government control which follows Government credits? Even if there are nations to lend,

what, it may well be asked, is the use of lending money to countries when the people will not work and when their still remaining resources are being squandered by constant issues of paper currency? One might as well pour it down a sink. Moreover, the external debt of most of these nations is already far greater than they can properly bear. Is it any remedy to increase it still further by borrowing more? Lastly, is it not imperative in face of such figures as the French and Italian just quoted to break the fatal habit of relying for imports on credit?

Clearly the problems before us are not so easy as Sir George Paish and his friends would seem to think. In fact, the granting of easy credit to Europe and nothing else would be like curing a drunkard by giving him more to drink. We may kill him at once if we cut off his drink altogether, but if we go on giving him as much as he wants he will certainly die fairly soon anyway. It is not by easy credit-taking that the European nations can establish their equilibrium, but by the very opposite—namely, by the most painful efforts at readjustment, by diminishing their consumption of imports to the very lowest point, by buying from countries who can afford to sell to them, by getting their imports from fellow-sufferers in distress, food from Russia and Roumania, manufactures from Germany, and so on, and by taking advantage of the depreciated exchanges to increase their exports, so far as they can, outside Europe. It is essential that the real economic burden should weigh heavily on each individual. It is only by his efforts and sacrifices that the evils we are all suffering from can be remedied. An easy supply of commodities on credit, especially if coupled with increased purchasing power from increased credit and currency, will merely confirm his optimism and his extravagance and make the evil day more evil when at last it comes. Moreover, most of our troubles cannot be cured by credit. Except in so far as it provides essential articles not procurable internally, credit cannot restore the railway systems or recover lost foreign markets. And neither credit nor anything else is of value, if fighting one another is to be the chief industry of European nations, or if workmen will not work. Moreover, if further inflation of credit and

currency constantly increases the public's purchasing power, credit might do actual harm in increasing instead of diminishing unnecessary imports. Such credit as can be granted must be for the purpose of increasing exports and not for internal consumption. It must be conditional on drastic internal reforms. Most countries have got to face the most disagreeable tasks at once. They are heading straight for bankruptcy unless they balance their budgets, limit their currency issues, reduce by taxation the abnormal purchasing power in the hands of their publics, and decrease consumption. The grant of credit should not be made to enable them to evade these disagreeable reforms, but, on the contrary, should be conditional on their carrying them through. Otherwise matters will merely be made worse. French credit, for instance, has suffered severely from the reluctance of France to tax herself. Public sentiment abroad rightly judges that it is useless to help her until she helps herself. The extent to which she has suffered abroad by her policy is measured by the almost complete fiasco of her recent offer of Treasury Bills in London. Mr. Lloyd George has promised her a loan, but its success depends on the British public, and they will certainly not subscribe until it is absolutely clear that the French nation mean to stand up to their burden. When they do this—as no doubt they will—it will become far easier to help her to face the very serious problem of balancing her foreign trade.

Let us admit, then, that we all of us depend in the main on ourselves and on the efforts of each individual citizen, and that he will be moved to the right course, not by making things easy for him, but by making them hard, as they must be. Europe must return to political sanity, must renounce its national hatreds, must abandon its fantastic dreams, must tax itself, live hard, and rely as far as may be on its own resources.

It was to lay stress on these necessities that an international memorial was recently addressed by representative bankers and others in each country to the Governments of the United Kingdom, the United States, France, Holland, Switzerland, Sweden, Norway and Denmark. That memorial pointed out that—

The war has left to conqueror and conquered alike the problem of finding means effectively to arrest and counteract the continuous growth in the volume of outstanding money and of Government obligations, and, its concomitant, the constant increase of prices. A decrease of excessive consumption and an increase of production and taxation are recognized as the most hopeful—if not the only—remedies. Unless they are promptly applied, the depreciation of money, it is to be feared, will continue, wiping out the savings of the past and leading to a gradual but persistent spreading of bankruptcy and anarchy in Europe.

There can be no social or economic future for any country which adopts a permanent policy of meeting its current expenditure by a continuous inflation of its circulation and by increasing its interest-bearing debts without a corresponding increase of its tangible assets. In practice every country will have to be treated after careful study and with due regard to its individual conditions and requirements. No country, however, is deserving of credit, nor can it be considered a solvent debtor, whose obligations we may treat as items of actual value in formulating our plans for the future, that will not or cannot bring its current expenditure within the compass of its receipts from taxation and other regular income. This principle must be clearly brought home to the peoples of all countries; for it will be impossible otherwise to arouse them from a dream of false hopes and illusions to the recognition of hard facts.

The memorialists further pointed out that Europe was short of working capital, and that—

while much can be done through normal banking channels, the working capital needed is too large in amount and is required too quickly for such channels to be adequate. They are of opinion therefore that a more comprehensive scheme is necessary. It is not a question of affording aid only to a single country, or even a single group of countries which were allied in the war. The interests of the whole of Europe and indeed of the whole world are at stake.

They stipulated, however, that a first condition of granting any country further assistance should be that the expenditure of the various European countries must be brought within their taxable capacity, and the burdens of indebtedness as between the different nations brought within the limits of endurance. In order that the great problem of saving Europe from collapse should be investigated, the memorialists urged that an international financial conference of the countries chiefly concerned, " which should include the United States,

the United Kingdom and the British Dominions, France, Belgium, Italy, Japan, Germany, Austria, the neutral countries of Europe, and the chief exporting countries of South America," should be summoned forthwith. They concluded by the statement that all the information at their disposal convinced them that very critical days for Europe were now imminent, and that no time must be lost if catastrophes were to be averted.

An answer to this memorial has already been given by the Governments of the United States and of Great Britain, and as a result of the reply of the British Government, the Council of the League of Nations has now determined to summon an International Financial Conference. The United States in a Treasury memorandum makes it brutally clear that the United States itself must not be looked to for the grant of further Government or banking credit for Europe. Mr. Carter Glass, the Secretary of the Treasury, lays stress, and proper stress, on the necessity of each European country depending upon the independent activity and resourcefulness of its citizens, and upon each individual returning to a normal life of industry and economy. The rectification of the exchanges, now adverse to Europe, lies, in his opinion, primarily in the hands of the European Governments. "Relief would be found," he says, "in disarmament, the resumption of industrial life and activity, the imposition of adequate taxation, and the issue of adequate domestic loans. The American people should not be called upon to finance, and would not, in my opinion, respond to the demand that they should finance the requirements of Europe in so far as they result from failure to take these necessary steps for the rehabilitation of credit. If the people and governments of Europe live within their incomes, increase production as much as possible, and limit their imports to actual necessities, foreign credits to cover adverse balances will most probably be supplied by private investors, and the demand for a resort to such impracticable methods as Government loans and bank credits would cease."

There is very much in the statement of the Secretary of the Treasury with which all bankers and economists would agree. Apart from the inherent evils of Government credit, none of the countries which might be expected to grant credit,

particularly the United States, Great Britain and the British Dominions, can be regarded as in a position, if times were normal, to grant large credits, either banking or Government credit. Banking credit is over-extended in all of them, and wants reducing, not increasing. With our own dollar exchange at $3.35, the cold-blooded advice of the Currency Commission to trade only with countries which can pay cash —in other words, to turn our backs on nearly all Europe— would seem sound common-sense, though it would be short-sighted to try to carry it out literally. In the United States there are a good many indications of an overstrained banking situation too. The banks are not in a position to extend long term foreign credit, and it is quite clear from the rates to be earned on foreign securities now—Anglo-French bonds yield nearly 11 per cent—that no self-respecting Government with regard for its credit could raise a loan there direct from the investing public.

The Secretary of the Treasury is embarrassed also by the attitude of Congress, whose assent to any further loans must be obtained. Congress has not shown any decided sympathy with Europe lately or alacrity in helping her. Congress, too, is all on the tack of economy, of no more Government borrowing and so forth, a very sound policy for purely internal reasons. Moreover, we must not in the next year expect any very decided policy from the American executive. President Wilson is ill; it is the year of a Presidential election; and the Government machinery of Washington cannot be running easily. The Secretary of the Treasury in the circumstances very naturally fears even to approach the task of assisting Europe by direct Government advances. His attitude may perhaps be expressed in Hamlet's words:

> The time is out of joint: O cursed spite,
> That ever I was born to set it right!

We shall, moreover, not do the United States justice unless we recognize both that she has granted enormous Government credits to Europe since the Armistice and also that she is suffering from a good many of the evils of inflation and financial strain which are plaguing us. It is all very well for us to say

that Americans should economize and not speculate and that if they acted prudently their resources would be ample for all needs. That may be so, but Europe is certainly on this subject not in a position to throw stones. On the other hand, the memorandum of the United States Treasury, while sound in many respects, takes too little stock of the unprecedented and extreme character of the crisis. True it is that in normal times a depreciated exchange by encouraging exports and discouraging imports brings its own remedy. But this is not so now, when the import of raw materials must first be made in order to make export possible. If no such import is possible, affairs go from bad to worse. Again, Europe's unfavourable balance of trade is so huge that an attempt to make her pay her way at once, as Mr. Carter Glass proposes, may mean so great a restriction of imports as to prevent her even getting the food and primary necessities to keep her population alive. Mr. Glass expresses a pious hope that the private investor will do what the Government and the bankers cannot. Permanent investment in foreign loans is the normal method by which one country provides working capital for another and is the one this country followed to a very large extent before the war. But the American investor is not used to foreign loans ; speculation is rife in the United States and there is little reason to suppose that he will subscribe to European loans on any terms which can be accepted by Europe.

In one important respect, too, the United States Treasury appears to be under a serious misapprehension. It interprets the international memorial, to which reference has been made, as contemplating that the United States should be the only lending Government, and that all other European Governments should be recipients of credit from the United States. This, however, was by no means intended. The object of the memorial was to suggest an international conference, at which some plan might be worked out, by which, subject to necessary internal reforms, the importing countries, desperately in need of raw materials, might obtain on credit those raw materials from the exporting countries which possess them in abundance. The United Kingdom and the British Empire in

general would certainly be, in these circumstances, required to give and not to receive credit, as would be also certain neutral countries in Europe, the South American exporting countries and others.

The answer of the British Government is more sympathetic. The British Government state that, in their opinion, the picture which the memorial presents of the financial and economic conditions resulting from the war, and of the grave economic and social dangers which, in consequence, confront the whole world, is not exaggerated. All the information in their possession convinces them, the Chancellor of the Exchequer states, of the urgency of the problems to which the memorial draws attention. But Mr. Chamberlain goes on to point out that it is doubtful whether the participation of the United States Government in any conference could be secured, and it is obvious that the attitude of that Government must gravely affect the influence and even the utility of such a conference. He accepts, however, the view of the memorialists that such a conference might exercise a powerful influence in securing those measures of internal reform in the countries concerned which would not only be a necessary preliminary to any further assistance by foreign Governments, but are equally necessary as a preliminary to any extension of commercial credits. He concludes as follows :—

> The situation is so grave that His Majesty's Government are unwilling to omit any act which may help to alleviate it by bringing home to all concerned in this country and elsewhere a true appreciation of the nature and character of the difficulties with which the world is confronted, and which may at the same time indicate the only methods by which these difficulties can be overcome. Under these circumstances His Majesty's Government will be prepared to appoint representatives, if invited to do so by one of the Neutral Countries or by the League of Nations, on being satisfied that the Conference will assume a really representative character.
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> But the limits within which the co-operation of His Majesty's Government is practical must be clearly understood. They are impressed with the futility of attempts to solve the grave problem of reconstruction by a continuous process of new borrowing, whether in the form of internal loans to cover deficits on current expenditure, or in the form of external loans advanced by one Government or another. They have themselves laid down as a cardinal feature of

their own policy the cessation of new borrowing by the British Government and the establishment of an adequate sinking fund for the reduction of debt out of the revenue, and they have taken steps to stop inflation of currency. His Majesty's Government have also publicly stated that they are not prepared to grant further advances to other Governments which involve either new borrowings by this country or the taxation of our nationals for the purpose of making loans to the Governments of other countries, and His Majesty's Government cannot, in view of the immense liabilities which this country has already assumed in the prosecution of the war, adopt either of these alternatives.

His Majesty's Government have, however, felt it necessary, in fulfilment of what they conceive to be the duty of the United Kingdom, to make a contribution worthy of the traditions of the nation to the reconstruction of Europe, to admit certain particular exceptions to the general principle that loans from Government to Government should cease. They are at the present moment engaged in discussions with the Governments of Canada, the United States of America, France, and certain other countries, including some which did not take part in the war, in regard to the provision of Government credits to Austria and Poland for the supply of foodstuffs and raw materials sufficient to enable those countries to avert famine and restart industrial life. His Majesty's Government felt compelled publicly to state in November last that, however desperate the need, they could not participate in measures of relief unless they were assured of the co-operation of the Government of the United States of America to an extent which would make it certain that this country would not be called upon to incur additional expenditure in the United States of America. The movements of the foreign exchanges since November last emphasize the difficulty with which His Majesty's Government were then confronted. In order, therefore, to avoid any possible misconception, His Majesty's Government desire to make it absolutely clear that, if they were to agree to take part in a Conference such as the Memorialists propose, it would not be with the idea that it was possible for the United Kingdom at this stage to make any considerable addition to its liabilities, and that if the grant of credits in any form were to be recommended by the Conference, His Majesty's Government could not support or take a share in any scheme which involved an addition to the liabilities of the United Kingdom for expenditure in America.

A day or two after the reply of the Chancellor of the Exchequer appeared in the Press, the Council of the League of Nations, taking note of the views of the British Government, determined to invite the nations chiefly concerned in the financial problem to an International Conference. The utility of the Conference will be impaired by the fact that the United

States Government will not send representatives. But Europe is bound to consider her own problems, and England, standing half-way between Europe and the New World, has done well to co-operate. An International Conference cannot work a miracle. But it may at least bring all the nations concerned to face the real facts, to convince the countries in need of borrowing how little there is to lend, and the countries which have still some power of lending how grave is the state of the would-be borrowers. Out of this may grow a greater spirit of co-operation and mutual assistance. It would be folly, however, to suppose that any Government measures can do very much or can replace private enterprise and self-help. Europe must face the situation. She will have to pass through a time of extreme difficulty, and it is hard to see how the ordinary machinery of credit, which is temporarily breaking down, is to be replaced. It is difficult, indeed, to see how, without the most drastic reductions of imports, with the consequent lowering of the standard of life within their countries, the great industrial States of Europe are to win through the next few years. Possibly something may be done by the actual control from this country and the United States, through private enterprise, of large undertakings in the destitute countries; for instance, it might be a profitable business for large interests in this country, in return for obtaining control, to provide the working capital for steel works, railways, or other big undertakings in Central Europe. This is, indeed, a very probable development in the next year or two, though it is difficult to say to what extent it will be carried out, particularly owing to the political instability of Europe. In any case it cannot completely solve the problem. Whichever way we turn, and whatever plans we may lay, the immediate future is obscure.

Certain measures might indeed be taken quickly, and one of the first is to amend the Reparation Settlement. On this question the writer is in general agreement with Mr. Keynes's book. Unless every plan of mutual assistance in Europe is to be quite unworkable, some definite sum which Germany must pay must be fixed upon, she must be left to find the means of paying it, and the Reparation Commission in its present form

must be abolished. As to Germany's capacity, Dr. Melchior, the head of the German Delegation at Versailles, has recently given his opinion :

> Before the war Germany's imports exceeded her exports by Mk. ½ to 1½ milliards yearly, and this was adjusted by the freightage receipts of German ships and the revenue from foreign investments. To-day Germany is denuded of raw materials, food, and fodder, and the trade balance for many years will have to lie even more largely on the import side, but there are no longer freightage receipts and foreign investments to counterbalance. Germany is, therefore, dependent on foreign credit. The raw material credit will, it is hoped, be repaid chiefly by the export of the completed product. The food credits will, however, for the time form a permanent burden. It will, doubtless, be demanded by those providing them that the credits for raw materials and food shall take precedence of the indemnity claims, and to these payments must be added the cost of the army of occupation.
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> The German estimates for the current year show an expenditure of Mk. 24·2 milliards, as against a revenue of Mk. 25·3 milliards, leaving a surplus of Mk. 1·1 milliards. To the expenses must be added Mk. 2,659,392,000 for the cost of the army of occupation, which leaves a deficit of over a milliard, irrespective of the indemnity claims. There remains also the question whether the taxes will bring in as much as is allowed for in the estimates, for already the present taxes threaten to drain Germany's life-blood. In these circumstances it is extremely difficult to find a basis on which to calculate Germany's power to pay.

Germany's indemnity must, at present at any rate, consist in the main not of a balance of exchange due to her as a result of a favourable balance of foreign trade, but of actual commodities purchased by the German Government and handed over by it to the Allies—e.g., coal to France and Italy, and so on. To pay for these commodities the German Government must increase its taxation, and the real test of the amount of the indemnity over and above capital assets in the form of ships, securities, etc., such as we can get from her in the next few months, is the absolute upward limit of Germany's taxable capacity.

If, as is undoubtedly the case, we must revise the inflated notions of the Treaty, this country will get comparatively little. This need not trouble us much, since we have in the Treaty included claims which are inadmissible under the Armistice terms. It is a matter of honour, therefore, for us to

forgo them. On this question, as on the great European problems in general, it is the duty of bankers and other financial authorities to show the politicians and the public the way to sanity and international goodwill. The financial leaders of all countries, friend and foe alike, are the only people who understand what is happening to the world and the necessity, if our civilization is not to disappear, of co-operation by all to save it. If the leaders of the present capitalistic system cannot lead, but leave the world to its own ignorance, one cannot wonder if the masses, enraged by the sufferings which they will have to endure, end by overturning it.

XI

THE FINANCIAL AND ECONOMIC SITUATION

(SEPTEMBER, 1920)

Though the country is gradually settling down to a truer conception of the economic effects of the war, it is doubtful whether the different sections of the community have even yet grasped the nature and extent of the sacrifices they must necessarily involve. Though it may be true to say with Mr. Lloyd George that the country has made a stupendous effort at reconstruction, and with Mr. Chamberlain that in our financial problem we are over the worst, it remains also true that the peculiar circumstances we are still subject to—particularly the abnormal demand of the world for certain commodities which we can supply, such as coal, textiles, machinery and so forth, and the temporary absence of European competition —enable us to support economic conditions both as regards wages and interest which we shall find a heavy burden indeed when this demand becomes less intense and this competition revives.

At present our industries seem able not only to stand wages, which have in some important cases risen considerably more than the cost of living, but also to pay interest on capital of, say, 8 per cent as compared with 5 per cent before the war, mainly because they have been able to charge the consumer, and particularly the foreign consumer, what they liked. The Continent generally had to have our coal, and the profits on its export have been consequently very great. Manchester thought that China and India must take our cotton goods at any price. They have taken them, though eventually, as Manchester was concerned to find, they preferred even at a sacrifice

to go without. So great is the world's demand for goods that quite possibly the seller may for some time still be stronger than the buyer, and prices may be maintained. But it is quite certain that in the end we shall have to measure our efforts against those of other European countries. Some of them, such as Germany, will, by the nature of things, and by the necessity of paying reparation in particular, be compelled to work very hard, live very sparingly, and export to the greatest possible extent. The maintenance of our foreign trade in manufactured articles will then depend on the prices we can afford to sell at, and these will depend in the main on the relative efficiency of our labour and management and the relative scale of our wages. Our home trade will depend on the real purchasing power of the community, and that will be dependent on our actual production, and not on the artificial stimulus of rising wages and rising prices.

As long as rising prices could chase rising wages, and currency and banking inflation accompany both, there was an appearance at any rate of great prosperity and home trade was very active, because the rising wages and abnormal profits placed temporarily in the hands of large classes increased purchasing power. But this was a process bound ultimately to lead to a financial crash, such, for instance, as Japan has already experienced to a more or less serious degree. The Government and the Bank of England respectively have therefore done their best to put an end to this rake's progress by limiting the amount of currency notes that can be issued, by raising the Bank rate and the rate of interest on Treasury Bills, and the bankers in general have co-operated by putting up their rates on loans, and restricting to non-speculative purposes the credits granted. While it is not intended to discuss here these hotly disputed measures, as to which wide differences of opinion exist in the City, they have, in the writer's opinion, undoubtedly tended to prevent further inflation.

Rationing of credit at a lower rate by a few chairmen and managers of banks is not an effective alternative to high interest rates. These gentlemen, however great their ability and experience, cannot have the omniscience required to determine which industry and trade should have credit and

which should not. A rise in interest rates, on the other hand, with all its disadvantages, automatically directs capital—insufficient in amount as it is for all crying needs, into those channels where it is most urgently required of all. Rationing of credit by itself would suffer from the same evils as Government regulation of prices, rents and so forth. The housing *impasse*, due to the fact that the rent of houses bears no relation whatever to their cost, is merely one instance of the morass of difficulties into which such courses lead us.

If, however, inflation is now checked, then prices should cease to rise, and the purchasing power of the community will cease to be artificially stimulated. As the true effects of the high cost of living and the huge taxation then begin really to have their effect, the demand for the products of home trade will diminish, and manufacturers will not find a means of paying higher wages by charging higher prices to the public, for the public will not buy. Unemployment is likely then to be very serious, and it will become apparent that the impoverishment of the country by the war cannot possibly have the paradoxical effect of ensuring a higher standard of life for the people, and that that cannot be attained except by hard work and economy on the part of the whole community, making good, and more than making good, the losses of the war.

We have still, therefore, to brace ourselves to further efforts. The first task of all is for the Government to put our finances in order. We can never tackle our social problems unless we secure stable prices, and, whatever may be the other influences affecting prices, it is certain that stability can never be reached if the Government does not restore order to its finances. It is essential, therefore, that the Government's revenue should cover its expenditure, including in that term all interest and sinking fund payments on the National Debt and all necessary repayments of foreign loans, and that in addition a considerable sum should remain over for the gradual reduction of our floating debt. From the results of the recent issue of 5–15 year Treasury Bonds, it is apparent that the investing public is in no mood to subscribe large sums to the Government by way of loan, even to reduce the floating debt. The Government is necessarily obliged, therefore, to look at

present to taxation as its only resource. It would have been well if many of Mr. Chamberlain's critics had borne these obvious facts in mind. Mr. Chamberlain had in this financial year 1920–21 to meet a total estimated net expenditure, exclusive of debt reduction, of £1,184,102,000. (This figure, it appears from the daily Press, has already been increased by some £20,000,000 in Supplementary Estimates, and the political outlook in Ireland and the rest of the world gives little assurance that this is the end.) As against this he estimates from existing taxation—i.e., with Excess Profits Duty at 60 per cent—to get £1,418,300,000, including special receipts of £310,756,000. If these latter receipts are deducted as being non-recurring, to meet an expenditure of £1,184,102,000 there is revenue amounting to £1,107,544,000. Whether, therefore, our taxation, can be reduced next year, when Mr. Chamberlain estimates existing taxation will give us £1,238,000,000, clearly depends on a reduction in Government expenditure. If our foreign and domestic policy involve us in further great expenditure, it may even be a question not of reducing but of increasing taxation.

Now it is a common ground among all those who are in a position to observe the effects of our present taxation, that it is already at a dangerously high level. Not only does it tend to diminish our production by reducing to an unreasonably low level the rewards of enterprise, but it draws away for Government purposes the capital so urgently required by private industry. Mr. McKenna has, indeed, estimated that the Chancellor is withdrawing for taxation nearly £250,000,000 more than the nation can possibly stand. In the light of this situation it is easy to understand the Government's refusal to consider the proposals of the Miners' Federation to divide between the miners themselves in the form of higher wages, and the community in the form of a reduced price of coal, the abnormal profits which will accrue on its export. These profits, according to Mr. Smillie's estimates, from which Sir Robert Horne does not seem to dissent, will amount to £66,000,000. There is no more reason why excess profits on coal should be shared between the workers and the consumers than the excess profits on the textile, steel, engineering or any

other industry. But these profits are abnormal and quite temporary, and to adopt the proposal of the Miners' Federation would mean not only to raise wages to a height which could not possibly be maintained in normal times, but to withdraw from the Government the whole proceeds of the Excess Profits Duty, estimated to amount to £220,000,000 for the current year. This sum would have to be found by other additional taxation. And the same body which proposes thus to reduce the Government's revenue is insisting on the other hand, not on any reduction of expenditure, but on its great increase by huge schemes of nationalization.

Mr. Smillie and his colleagues, who appear to hold the simple faith that there is in the possession of the richer classes an inexhaustible reservoir of taxable wealth, do not bother themselves with that side of the question, and no doubt will not, unless they ever come to have the responsibility of government thrown upon them. But some of Mr. Chamberlain's critics should know better. They are quite right that existing taxation is too high for our economic prosperity. They are quite right in declaiming against the Excess Profits Duty. But they have failed in giving any clear indication of an alternative tax they would prefer. They have hesitated to advise either a graduated or a flat tax on profits such as the new Corporations Tax, which imposes a flat rate of 5 per cent on the profits of all companies, on a sufficient scale to replace the Excess Profits Duty. Yet the Chancellor must have the money, and between now and next year some alternative more endurable than the Excess Profits Duty must be agreed upon. The evils of this latter tax are too great for it to be maintained. If taxation is to be cheerfully paid, it must appeal to the sense of fairness of the taxpayers. The Excess Profits Duty is essentially unfair. It is based on a standard—based on profits earned before the war—which has no meaning or relevancy in to-day's vastly altered circumstances, and it is consequently resented as being far too hard on some, and far too easy on others. It leads to the grossest extravagance, to the maintenance of high prices, and to the strangling of new enterprise.

No doubt any alternative will have serious disadvantages, for when taxation has reached its present height, any new tax

must have grave consequences. But there are only two other alternatives before the country, either for the Government to follow the spendthrift course of not balancing its budget and borrowing what is necessary either from the public, or if, as is probable, the public would not lend it, from the Bank of England—a disastrous course—or to reduce expenditure. To be forced to borrow largely from the Bank of England would merely be to undo all the efforts to check inflation. Borrowing from the Bank of England results in artificially increasing banking credit, and also currency, without any real assets behind the increase. It thus results in higher prices, and so brings us back to the vicious circle of increased cost of living, higher wages, greater Government expenditure, need for more taxation, worse profiteering, and so forth. Since it is not the Chancellor of the Exchequer but Parliament which is responsible for the scale of our expenditure, his critics would be wiser, and fairer too, if they turned their attention to persuading Parliament to reduce expenditure. It is satisfactory that a strong movement in this direction has now been inaugurated.

Parliament and the Government have, however, no easy task before them in putting their house in order. It was stated at the commencement of this article that the community has probably not yet realized the nature and extent of the sacrifices involved. Hitherto the process has been the one comparatively simple and popular in a democratic community of increasing taxation on the well-to-do, in order to provide uneconomically cheap bread, coal, railway fares, and so forth, for the bulk of the population. But, as already stated, this process has about reached its limit, and still heavier taxation would probably reduce revenue, instead of increasing it. It is indeed likely that, when a time of depression comes, even existing taxes will show a considerable shrinkage. If the comparatively few rich cannot be "squeezed" any more, there is no alternative but to reduce expenditure or to make the great mass of the nation pay more. We have had a recent example of the unpopularity of this process in the case of the increase of railway fares.

We are fortunate in the fact that one very important section

of our daily Press has been conducting a vigorous campaign against a "wastrel" Government, and in favour of the most stringent Government economy, and depicting to the enjoyment of its readers the poor taxpayer in various tragic guises under his excruciating burden. One might have supposed that a laudable attempt to obey its daily injunctions and to make both ends meet at least on the railways by raising fares might have aroused in its breast some faint emotion of sympathy. But far from it. The attempt has been pithily designated as the "fare ramp," and the public has been exhorted in the very largest letters, "not to weaken in its determination to resist this greedy grab." But—perhaps luckily—such contradictions tend to cancel one another. No one uses a weathercock as a compass. And there is a much larger problem involved than the inconsistencies of the daily Press. The trouble is that the path which our financial situation indicates to us, and will indeed compel us to follow, leads in exactly the opposite direction to that along which the Labour Party sees its goal. The Labour Party, having condemned the "Capitalistic system," must find another to take its place. It has not made up its mind to accept the extremer forms of socialism such as communism or syndicalism or even the nebulous "guild socialism," having a shrewd suspicion that the two former mean a revolution, which, it knows, would still further depress the general standard of living, and that "guild socialism" depends for its attractions on remaining nebulous and in the realms of fancy. While, therefore, it does not feel quite happy in its choice, and professes its determination to resist any extension of bureaucracy, it has more or less plumped for the only other known alternative—namely, state socialism or nationalization. There is no doubt of the soundness of the great body of Labour and the sterling commonsense which it has often shown in refusing to be led astray by reckless counsellors. But, while most of us sympathize with the main objects of the Labour Party, they will not be secured by this dreary creed of which Mr. Sidney Webb is the prophet. Of course, nationalization means bureaucracy and nothing else, for no one has yet suggested an answer to the riddle "When is a Government Department not a Government

Department?" Moreover, on a large scale nationalization would probably be found incompatible both with representative parliamentary government and with a great foreign trade. But it is not these results—no one of which will commend itself to the Labour Party—on which we wish to insist here, but on the fact that nationalization means nothing else but a vast extension of Government activities, and accordingly a great extension of Government expenditure. It is no answer to say that the Government will make everything pay. All experience shows that it will not. It is quite certain that the Government's *net* expenditure would be very largely increased by the Labour Party's programme. The greater the control by Government, the greater the expense. The personnel of the Ministry of Labour alone has gone up from 4,400 in 1914 to 17,324 in June, 1920.

But no great increase of Government expenditure is consistent with our financial health. Since further taxation is hardly possible, and is in any case not likely to prove remunerative, no other method would be open to the Labour Party than to follow Lenin's method and finance the Government by printing currency notes. The consequences must be disastrous. Our currency would suffer further depreciation; our credit would collapse; our exchanges fall rapidly; our imports would be enormously costly; prices would rise rapidly; profiteering would become more rampant; and every social evil we now suffer from would be enormously accentuated. There is no escape from these consequences even if the extremists had their way and nationalization was inaugurated by wholesale confiscation. The impossible task of raising great Government loans might be avoided thereby, but not the necessity of raising further money to meet the increased annual Government charges.

The fact is, that there is no alternative to retrenchment and economy. Russia has been ruined for the time being by extremist financial methods; but we should be killed dead. No foreign nation has been able to trade with Russia for years. Imagine our plight if foreign nations were to cease trading with us for six months. We should have been all starved before then. A collapse of our credit, currency and

exchanges, which would be involved by a spendthrift Government reckless of our financial stability, could quickly accomplish what the German submarines failed to do.

It would be very pleasant if we could find our "new heaven and new earth" under Mr. Smillie's ingenuous guidance by the simple method of paying still higher wages and simultaneously reducing the price of the product to the consumer. Unfortunately, we cannot eat our cake and have it, either under nationalized or private industry, though we should in the two cases follow the road to ruin by different paths, if we tried. If the Government were to run the industry of the country and found itself unable, if forced to pay higher and higher wages, to make both ends meet, it could, as Governments have very often done, follow "the primrose path" to ruin by debasing its currency and living on the printing-press. But if industry is still in private hands, the end is reached by a shorter method. A private company cannot issue notes to pay its workmen wages. If those wages have reached a level higher than is justified by the real value of the product made, the company must close its doors, for it would be working at a loss. The true facts disclose themselves more quickly, and therefore the remedy is more quickly found and the ruin less widespread. At the moment the great profits on our export trade help to disguise the true facts, but without any doubt wages in many cases are reaching the point, if they have not already passed it, after which they will be disproportionate to the value of the work done. To raise them further can merely increase the cost of living and depress still further the standard of the unskilled and cheaper classes of labour, and, when the competition becomes more severe, must lead to widespread unemployment.

The fact is, that all classes are faced with the necessity of great sacrifices. That was the answer to Mr. Chamberlain's industrial critics who complained of excessive taxation. Until we can reduce our Government expenditure materially, all those who have money must be willing to pay a very large part of it away to the Government. Taxation may have reached its limit, but it cannot yet be reduced. Similarly, Labour must play its part. Its future well-being does not

depend on its "squeezing" the well-to-do, for they are being "squeezed" almost dry now. Further increases of wages are, therefore, merely absorbed by further rises in prices. Labour, in fact, pays for them. It cannot pull itself up by its boot-straps. The losses of the war, which must hit the whole community, can only be made good by hard work. Our crying need is for more capital. Though our revolutionaries may bawl in season and out of season for the destruction of "Capital," it is only by an increase of capital that real wages can be increased. Unless we are to face a disaster, we must persuade the voters that if they allow themselves to be led by the blind they will fall into the ditch. The more sober leaders of Labour can hardly be unaware that if they wish to better the lot of their followers, their policy must be that one which offers the greatest opportunity for increasing the country's capital. Any other will merely lead to disappointment and disillusion. Similarly the possessors of capital should realize that its waste on ostentatious and useless expenditure is a crime against society.

It is from this point of view that all schemes of socialism must be judged. Socialism cannot get rid of the need for capital and saving. It merely transfers the duty of saving from each individual to the State. The State can save only by allowing its citizens to consume less than it can persuade or compel them to produce. In theory it is arguable that a state can save as efficiently as its citizens, and can be strong enough to insist on and organize as much production and as much saving as are achieved by the motive power of private property and enterprise. Those who know from experience the inevitable methods of governments take a different view.

These reflections may sadden the heart of the ardent social reformer. But they need not lead to pessimism. Meanwhile let us remember that the greatest social reform of all is to restore our Government finances. Everything depends on sound finance. If we insist on the immediate achievement of other and much-needed reforms, at the expense of sound finance, we shall fail to attain them now and put off their attainment to a still more distant future.

XII

THE INTERNATIONAL FINANCIAL CONFERENCE AT BRUSSELS AND ITS LESSONS *

(December, 1920)

Nothing is more important to our own country as well as to others than that the public should understand the true character of the economic and financial difficulties which face every European country, and the only means of remedying them. Such an understanding—it would seem from many indications —is not possessed either by the great mass of the people or by the leaders of the Labour Party, or indeed, it may be thought, by some at least of the members of the Government itself. This is not to be wondered at. The economic and financial history of the war has been of such a character as to mislead all but those who have grasped and held fast to certain fundamental economic truths. The great mass of the people in particular are not to blame. They have seen money poured out like water for four or five years ; the purses of the governments seemed for the purposes of the war absolutely bottomless. It was natural to conclude that there existed and still exists somewhere within the community an inexhaustible reservoir of wealth, or one at least copious enough to secure a fair standard of living for every class. They were not able to see that all this outpouring of our substance on the war was accompanied by a constant deterioration of our economic situation, by a vast loss of national capital, and by the creation of a huge load of debt, internal and external—in fact

* The address of the author on Public Finance delivered to the Conference in his capacity as Vice-President is reprinted in the Appendix.

that we were like a spendthrift, living more or less at our ease by wasting our capital. And, when the war was over, in many facile speeches, our politicians promised the people a land fit for heroes, a new way of life, a higher standard of living—promises which, since they were not likely to have been deliberately misleading, must have been the outcome of ignorance, and which with the best will in the world neither they nor any other human being can possibly fulfil, at least until after, not months, but years of effort and sacrifice, labour and saving, the whole community has first climbed arduously back to the level of prosperity and wealth which it had reached in 1914. Fortifying the conclusions as to our wealth, to which the experience of the war had erroneously led them, by the magnificent pictures of the good time coming, in which Mr. Lloyd George's imagination in particular led him to indulge, the great mass of the people have naturally become convinced that the wealth they desire in order to maintain and improve their standard of living is still somewhere within the community if they can only get hold of it.

In reporting a few days ago the proceedings of the International Financial Conference to his paper, a British journalist wrote that remarks had been made by certain members which might be interpreted to mean that in their view not even the standard of living of 1914 could now be maintained. He added that Labour everywhere would take this as a direct challenge by capitalist interests. Such a statement is meaningless. The maintenance or non-maintenance of a community's standard of life does not depend on governments or on capitalists. It depends on that community's production of wealth, both for its own use and for exchange against the wealth of other nations. If in England, for instance, production, for whatever reason—loss of capital in the war, less energy in the workers, loss of ability and enterprise in the directors of industry, incapacity or unwillingness of the rest of the world to buy—is less in 1920 than in 1914, then the standard of life in 1920 throughout the community cannot be as high as in 1914. It may be that quite temporarily the deterioration of that standard may be postponed by reducing the national savings, either by too

excessive taxation or by subsidies on bread or housing or railway rates or other devices for concealing the true economic situation—i.e., by sacrificing future progress to present needs. But it will not amount to much and must be paid for later. If production is much less in 1920 than in 1914, then the standard of life cannot by any means whatever be maintained. Indeed, over the greater part of Europe this result has long been reached, and owing to the failure of production the standard of life is now very far below that of 1914. It would be useless for the governments of Germany and Austria and of many other countries, too, to claim that the pre-war standard of life had been maintained; it would be a mockery to *their* populations to promise them a land fit for heroes. The day of self-deception as to the true economic position of the community, and as to the results of the war and of excessive government expenditure in impoverishing a country, is long past with them. Are *we* going to learn the lesson which they teach us or to follow in their wake? Can we learn particularly from Germany's example of the extraordinary difficulties which threaten to overwhelm a highly developed and thickly populated industrial nation, as it is inevitably driven by the loss of capital, by excessive government expenditure and increasing inflation, further and further down the road to financial ruin? For in our country there are evident and inevitable signs of a growing difficulty, hitherto veiled by the artificial financial methods of the war and the temporary after-war boom, in maintaining our general standard of life. Whether we are at all able to maintain during the immediate future among the mass of our population our existing standard depends very largely upon the extent to which we observe the financial and economic principles clearly laid down by the International Financial Conference at Brussels. They are therefore well worthy of careful consideration.

That Conference was a unique assembly. Eighty-six representatives, all of them versed in financial and economic affairs, were present from thirty-nine countries, whose inhabitants comprise three-quarters of the world's population. These representatives, while appointed by their several governments,

attended as experts and not as spokesmen of official policy. They expressed their personal opinions with freedom; they voted with entire liberty in accordance with the dictates of their experience, and so clear, in their view, after a fortnight's arduous examination and discussion, was the nature of the financial evils from which the world is suffering, and the remedies therefor, that the final report of the Conference and all the resolutions of the various commissions were adopted unanimously. Notwithstanding its comparatively brief duration, the Conference did its work with thoroughness. It had before it detailed statements of the financial situation of all the thirty-nine countries represented; it listened in addition to a verbal explanation from the spokesmen of each country; it debated in full conference the four great questions of Public Finance, Currency and Exchange, International Trade and International Credit. Each of these four subjects was referred to a separate commission to draft resolutions, and finally these resolutions, together with a general report, were unanimously agreed to.

The Conference found that the root cause of all the world's financial predicaments was the great destruction of capital caused by the war. This loss of capital takes many forms. Its most striking form is in the actual destruction of towns and villages and countryside in the devastated areas of France and Belgium. But it is equally to be observed in the deterioration of railway systems, roads and houses, in the enforced sale of foreign securities to countries outside Europe, in the huge external debts of the belligerent countries, and, particularly in Central Europe, in the loss of working capital in the form of stocks of raw materials. England, it has been sometimes estimated, had in 1918 lost one-sixth of her pre-war capital; the German Government estimated officially at Spa that the national capital of Germany had been reduced by more than half.

So intense during the war were the demands of the governments on the resources of their nations that they could not be met solely out of the annual product of the people, but had partly to be met by dissipating their capital. So great were they, too, that they could not be paid for out of taxation

expressly imposed or out of loans from the people's real savings. All governments resorted, therefore, to creating the purchasing power they needed by expanding according to their necessities either paper currency or banking credit, without any corresponding increase in real wealth. In other words, by continuously expanding currency and credit without expanding wealth they constantly debased their standard of value, until £1 now is worth less than 10*s.* in 1914; one mark is worth under 1*d.* in Germany as against 1*s.*; one krone in Austria is worth, say, about one-fifth of a penny instead of 10*d.*; while in Russia roubles which before the war would have been worth, say, £100,000, can now be bought as a speculation for less than £20. Such inflation is merely a method of concealed taxation, by which a government takes from its citizens their wealth, not by actually forcing them to pay it over to the tax-gatherer, but by reducing its value. The more impoverished a country the greater the compulsion upon it to resort to these methods, the greater the extent to which it trenches upon its capital, and the further it is driven down this road to ruin. In the advanced stages of the disease, upon which Austria and Poland, for instance, and it may be said Germany too, has entered, to do anything to arrest it becomes a matter of extreme difficulty.

So far-reaching and corrupting are the effects of inflation that it is worth while to define them with some care, especially since many of the evils which flow from it are usually attributed popularly to quite other causes, and in consequence entirely futile remedies are proposed.

In the first place, inflation in this and other countries is the root cause of profiteering. Indeed, inflation and profiteering are Siamese twins. You cannot cure profiteering without curing inflation, and if you cure inflation you will cure profiteering. As long as prices continue to rise, whoever makes or buys or holds goods at one price and can in a short time sell them at a higher price must "profiteer." Profiteering is not an inherent vice of the capitalist system. In normal times and with stable prices, and when the losses which capital suffers are counted in with the profits, it is more than doubtful whether the profits of all trade and industry amount to more than a very small percentage on the capital employed. Certainly

the idea that by the distribution of these profits you can largely increase wages is baseless. By causing profiteering, inflation is, therefore, responsible for the disproportionate importance attached by Labour to the profits of Capital. There is nothing, indeed, which has done so much in all countries in the last five years as profiteering to poison the relations between Capital and Labour, and for this reason alone it is extremely important to check inflation. Failing this, all other plans proposed by the Government or the Labour Party for reducing the cost of living are futile.

In the second place, what the profiteer, whether capitalist or wage-earner, gains is lost by all those living on fixed incomes or salaries or on wages which have not increased with the increased cost of living. The extent of profiteering is the measure of what these classes have lost. Indeed the "new poor" are among the greatest sufferers through the war, and the greatest of all where inflation has been most rampant. If our inflation had equalled the Austrian, a widow or schoolmaster or clergyman, having £1,000 capital saved up and deposited in a bank in 1914, would now find that £1,000 reduced in value by the depreciation of currency to £20. In this country the average income of the country clergymen of the Church of England is probably now far below that of the skilled artisans and miners.

In the third place, inflation, by necessitating a constant readjustment between wages and prices—the vicious spiral, as it is now known throughout Europe, in which wages and prices endlessly chase one another—causes constant strikes and Labour unrest, very seriously impeding production. When wages increase faster than production the real cost of living increases to all those who are not strong enough to insist upon further increases of wages or salaries, or who cannot increase their incomes. In other words, the strong unions and the profiteers unwittingly trample down the weak, and bring them either a lowered standard of life or unemployment.

In the fourth place, inflation, by depreciating the currency, depreciates the exchanges. Thus all imports cost more, and again, particularly in a country like ours, which depends so largely on imports, prices are driven up.

Fifthly, inflation, by increasing prices, constantly increases government expenditure. While revenue will ultimately increase in proportion to prices, expenditure tends to increase even more quickly and to cause a larger deficit, thus tending to still more inflation and a further increase in the cost of living. It is only quite recently, for instance, that railway and postage rates have been increased in any proportion to increased costs.

Sixthly, the constant changes in prices and in the exchanges restrict legitimate trade and industry and tend to replace them by speculation. This is another serious handicap to production.

Seventhly, in its extreme form, as seen in part of Europe, particularly Russia, inflation ultimately disintegrates society and leads to chaos and anarchy. The simple but brilliant Bolshevik plan of ruining Western civilization by forging unlimited quantities of each country's currency would have been wonderfully effective if it could have been put into operation.

For these reasons the Brussels Conference recognized that the first reform in Europe, on which all others depended, and indeed the only means of avoiding ruin, was to check inflation. No other task before the governments of Europe was comparable in importance and urgency. Underneath all the machinery of finance lay the fundamental necessity of increasing production and encouraging saving. Economically inflation impeded production, and discouraged saving; politically and socially it was responsible for very many of the common troubles of Europe. It is true that rapid deflation, as the Conference recognized, by bringing further instability and great depression, might be as bad as inflation. What was imperatively required was stability, bringing with it confidence, so that the urgent task of restoring lost capital might be facilitated. How then could stability be achieved? The Conference recognized that, limited as it was by its reference to the sphere of finance, it "could only deal with a part of the problem which faced the governments and peoples of the world."

Finance is, after all, only a reflection of commercial and economic life—a part only, though an essential part, of its mechanism. The

wealth of the world consists of the products of man's work, and the sum total of human prosperity can be increased only by an increase of production. All that any official or organized action can do is to create conditions which are favourable to production, and of those the most important fall outside the sphere of finance.

First and foremost the world needs peace. The Conference affirms most emphatically that the first condition for the world's recovery is the restoration of real peace, the conclusion of the wars which are still being waged and the assured maintenance of peace for the future.

"If the first condition," as the report of the Conference proceeds, "is peace between the countries of the world, the next is peace within each of them and the establishment of conditions which will allay the social unrest that is at present impeding and reducing production, and which will restore social content, and with it the will and the desire to work." Subject to these indispensable conditions the Conference advocated certain financial measures, for a full understanding of which its report and the resolutions of the different commissions should be studied with care.

First and foremost, the governments, municipalities and other local authorities must live within their means.

In the second place, "banks, and particularly banks of issue, should be freed from political pressure and should be conducted solely on the lines of prudent finance."

Thirdly, the creation of additional credit should cease, and governments and municipalities should not increase their floating debts, but should begin to repay or fund them by degrees. The Conference laid stress on the danger of large floating debts in themselves leading to further inflation.

Fourthly, the "natural regulator of credit is the rate of no interest, imposed by the central banks of issue. There is no reason why governments should be less subject than the rest of the community to whatever rate of interest is necessary for the proper restriction of credit. In those countries where the financial machinery is wholly out of gear, and the rate of interest ineffective, credit must be restricted to real economic needs."

Fifthly, commerce should as soon as possible be freed from all government control and impediments to international trade removed.

Sixthly, economy in expenditure should be exercised by

the whole population. "Such private action is the indispensable basis for the fiscal measures required to restore public finances."

Seventhly, on the question of currency, the Conference regarded the earliest return by all countries which have lapsed therefrom to the gold standard as highly desirable, but considered it "useless to attempt to fix the ratio of existing fiduciary currencies to their nominal gold value," or to attempt any sudden deflation of currency or to stabilise the value of gold. It rejected any notion of an International Currency or an International Unit of Account, and regarded any artificial control of the foreign exchanges as useless and mischievous.

Eighthly, as regards international credits and loans, it did "not believe that apart from particular decisions dictated by national interests or by considerations of humanity, credits should be accorded directly by governments." It thus summarily rejected all notions of vast international loans, of issues of League of Nations bonds, and so forth, which are wholly impracticable. It did, however, tentatively suggest for further consideration certain schemes for facilitating exports to impoverished countries either by special guarantees or some method of insurance. The Conference recommended that the League of Nations should arrange for further expert inquiry to be made as soon as possible into these schemes. Useful, however, as they may prove to be, it is certain that the part they can ever play is insignificant compared to the importance of encouraging credits through ordinary banking and financial channels, by a return to sound finance and freedom of trade and industry, in all countries requiring assistance.

It is not intended to discuss in further detail the more technical recommendations of the Conference. With the adoption of sound principles of finance, with general peace, internal and external, it will be easy to carry them into effect: without them it will be impossible. It is better, therefore, to confine our attention to more fundamental questions. The true meaning of the Conference's recommendations can be summarized in one sentence. Stability can be attained in one way and one way only—namely, by governments and citizens recogniz-

ing their poverty and learning to live within their means. Simple as this platitude sounds, it is a task now fulfilled by hardly any European country, and is indeed, so reduced have their means become, temporarily at any rate, beyond the powers of several of them. Even in our own country its adoption as our common aim would involve a revolution in the political and economic ideas of the majority of our people, and certainly in the programmes of the political parties. The efficacy of all the other recommendations, indeed, depends upon sound public finance. It is on this point above all others that the Conference insisted in its Report and resolutions. Its main conclusions may be summarized as follows:

1. Industry is suffering from a scarcity of capital. The more capital used by governments, the less is available for industry. Which is likely to use it most productively?

2. There is a "close connection between Budget deficits and the cost of living which is far from being grasped." "Nearly every government is being pressed to incur fresh expenditure, largely on palliatives, which aggravate the evils against which they are directed."

3. Budget deficits mean:

   (*a*) Further inflation of credit and currency.

   (*b*) Further depreciation in the domestic currency and the exchange.

   (*c*) A further rise in the cost of living.

"The country which accepts the policy of Budget deficits is treading the slippery path which leads to general ruin; to escape from that path no sacrifice is too great."

4. "It is therefore imperative that every government should, as the first social and financial reform, on which all others depend:

   (*a*) Restrict its ordinary recurrent expenditure, including the service of the debt, to such an amount as can be covered by its ordinary revenue.

   (*b*) Rigidly reduce all expenditure on armaments, in so far as such reduction is compatible with the preservation of national security.

   (*c*) Abandon all unproductive extraordinary expenditure.

(*d*) Restrict even productive extraordinary expenditure to the lowest possible amount."

5. Reduction in armaments is therefore essential.
6. All uneconomical and artificial measures including:
   (*a*) subsidies on bread, coal, and other materials, as well as demoralizing unemployment doles;
   (*b*) the maintenance of railway fares, postal rates, and other government charges on a basis insufficient to cover all the costs of the service given should be abandoned as soon as possible.
7. Where expenditure cannot be cut down within the limits of existing revenue, further taxation must be imposed.

What, then, are the lessons which we, in this country, can draw from the Conference? First of all, it is safe to say that owing to our splendid financial traditions of many years, and to the sound policy which Mr. Chamberlain and the Treasury have pursued in the past two years, Great Britain has hitherto come far nearer than any other country to meet in Public Finance the ideals laid down by the Conference. The simple statement made by Lord Chalmers of the huge taxation which we had imposed, and the commencement we had already made in the repayment of debt, made a great impression on the Conference.

Nevertheless, fortunate as is our position in comparison with our continental neighbours, we have not, in the writer's opinion, yet passed the crest of the hill or by any means definitely overcome all danger of further inflation. If, as seems unfortunately likely, we must face in the next year or two a period of severe trade depression, the government revenue, and particularly the Excess Profits Duty, is likely to show a decided falling-off. Revenue will cease to be elastic, and additional taxation, instead of increasing revenue, may diminish it by further diminishing the already insufficient stores of capital for industry, and by hampering production. On the other hand, government expenditure seems likely actually to increase, unless Parliament insists on its curtailment. The genius of Mr. Lloyd George's government does not exactly lie in economy, and official government apologists are already urging that expenditure cannot be reduced. On the other hand, schemes

of further public expenditure on unemployment insurance, relief works, and so forth, are foreshadowed. They may very likely turn out to be "palliatives which aggravate the evils against which they are directed." Whatever their merits, they involve an increase instead of a diminution in expenditure. In some form or other, therefore, the community in general must bear the extra burden imposed. If pay is given to the unemployed, then it must go to reduce the profits or the interest or the salaries or the wages of those who are working or have capital invested. If great highways are built out of London by the public authorities, they cannot be immediately remunerative. Yet the wages and materials must be immediately paid for, and the extra burden must be met by the taxpayers and ratepayers. And their burden, it may be said in general, is, in one way or another, either by causing increased cost of living or reduced employment, shared ultimately by the general community. Whatever you do, you cannot make something out of nothing. It is imperative, therefore, that every item of government expenditure should be most closely scrutinized. Above all, and by some means or other, the Government must continue at least to balance its Budget and to redeem gradually the floating debt.

This brings us to another and extremely important point. It is not only government expenditure which causes inflation. Inflation results also from an increase in banking credit unaccompanied by a proportionate increase in real wealth. In 1919 banking credit expanded enormously, and the increase in the liabilities of the banks of the United Kingdom amounted to nearly £450,000,000, an increase larger than in any war year. There are indications that the increase still continues. This increased purchasing power granted by the banks is due to the demands of industry, and these demands have been again due partly to enterprise which is legitimate, partly to enterprise which has been misguided, since the products made cannot be sold, and partly to additional requirements of industry due to increased wages and costs. Anything which increases costs tends to increase inflation. For instance, the recent coal strike will tend, temporarily at any rate, to increase the cost of living. It will reduce production, and so increase

scarcity and send up prices; it will reduce saving, and so capital, and tend to increase the rate of interest, which again will tend to increase prices; it will diminish our exports, and thus tend to prevent any recovery in our exchanges; in consequence, all our imports will cost us more than they otherwise would have, and so prices will be increased. This increase in prices in itself will lead to more currency being required, and to all companies needing more credit and more capital to carry their working stock and to continue their operations. Since the Government have definitely restricted the amount of currency which can be issued, the banks cannot, as during the war, continuously and without fear increase their credit facilities. Indeed, so great have been already the demands on them, that they have already had to restrict them. If, therefore, owing to increased prices further credit must be had and cannot be obtained, the companies concerned must restrict or abandon their operations, and so unemployment will grow. Moreover, any increase in the cost of living leads to demands for higher wages all round; and so the vicious spiral will mount.

But it does not need a strike to cause further inflation. The same results tend to occur whenever wages have reached an uneconomically high level—i.e., when they are disproportionate to the value of the output, that value depending, of course, on the effective demand in this and other countries for the product made. In normal times, and under private enterprise, the necessary adjustment must be reached by the closing of the factory concerned or the restriction of its output, or, in the case of agricultural products, the restriction of acreage, since the product will not be bought by the consumers, and that is what is already the case in many trades. But that does not so easily happen in the case of a necessity and a monopoly like coal. Clearly the mine-owners and the miners can continue for a long time to secure high profits and wages by increasing the cost of coal before the consumption of it will very largely decrease. But let us be under no illusion as to the results. Unless the production of coal increases, the higher profits and wages of the coal industry are secured by depressing the standard of the rest of the community, and, in all probability in particular the standard of those classes least able to defend

themselves, such as the unskilled and unorganized workers. One can liken the production of the country available for distribution in wages, interest, and profits to a blanket with which several people are trying to cover themselves, but which is too small. If one party is strong enough or selfish enough to manage to cover himself, some one else must be left out in the cold.

Most trades are, of course, not monopolies like the coal trade, and the most serious problem before the country is to arrive in industry in general at an equilibrium between the cost of production, of which wages will be the largest fraction, and the value of the article produced, or, in other words, on our power to sell it. The textile industry is depressed because the Far East finds our prices too high. Moreover, large contracts in railway and other materials are going to our European competitors, because their prices are lower than ours. It may be that we cannot retain our markets and avoid very great unemployment without an adjustment in wages; it may be that we can hold the position by increasing our efficiency; it may be that we can make the necessary readjustment by great emigration. One thing is certain. By one means or another an equilibrium must be reached. Merely to increase wages must merely increase inflation, with its endless evil consequences, and ultimately lead to the most widespread unemployment and distress.

It is useless to think we can live in a water-tight compartment of our own. We depend on selling our exports. If we are cut out by our competitors, we must either have unemployment or reduce our costs. The tendency is clearly in the direction of reduced world prices, and if prices come down profits will certainly come down, and wages may have to follow them.

The trades unions and the Labour Party insist, and rightly insist, on the vital importance of maintaining the standard of living. However sound is our financial and economic policy, the war has made that difficult enough in any case. The blanket is not large enough. But is it not irony that Labour, sincerely desirous above all things of securing this end, should by its action and policy be making it wholly unattainable?

Each strike, great and small, weakens *pro tanto* the community's power to maintain its standard. But, apart from these shocks, the main policy of the Labour Party appears to be the extension of government activities in every direction, with the certain consequent extensions of government expenditure. It is impossible to disguise from oneself that such a policy is in direct contradiction with the principles of the Brussels Conference. If the Conference is right, it must lead to further inflation, a further rise in the cost of living, increased taxation, and all the evils indicated above. Yet what does Mr. J. H. Thomas say, speaking on behalf of the Labour movement in his recent book, *When Labour Rules*. "Nationalization," says Mr. Thomas, who seems to regard it as the panacea of all economic ills, "will decrease the cost of the commodity to every one, it will leave allowance for a system of wages in advance of those appertaining to-day, and even then a margin which will go into the national exchequer and thus relieve taxation." These statements are entirely unsupported by any evidence or even by any arguments. It is important they should be, since, if the Brussels Conference is right, they are in the circumstances of the moment the exact opposite to the truth.

The spokesmen of Labour sometimes talk as if the standard of life were something independent of the joint efforts of the whole community and, indeed, of the whole world, something possessed by the Government, or the income-tax payers, which Labour could secure and keep, if it was only firm and determined enough. But, of course, that is not so. It depends on the national production of wealth, and unless an increase in government functions means an increase in national production it would become more difficult, instead of less, to maintain wages. The standard of 1914 can only be maintained by the production of 1914. And, unfortunately, production does not depend only on the efforts of Labour, or on those of Capital, or on anything we can do in this country. It depends largely on the prosperity of our neighbours, on their power to buy from us by selling to us in turn and also on their willingness to buy from us at the high prices necessitated by the high cost of labour and capital here. It is curious, indeed, to note that

some of the countries least directly concerned in the war find themselves in the greatest difficulties. Neutrals like Switzerland, with a favourable exchange, are in great straits owing to their inability to find purchasers for their goods, since their neighbours cannot buy. Nothing shows more strikingly the interdependence of the whole world. We cannot live on our neighbours' poverty. Until the world regains equilibrium, and until our neighbours recover, low production, unemployment, and hard times may be enforced on us. Whatever we do, we cannot escape the consequences by unemployment bonuses and relief works. We may distribute more widely the burden, but that is all. And unless we manage at all costs to hold to the path laid down by the Brussels Conference, our troubles will grow still worse.

Is it impossible for all parties, Coalition, Liberal and Labour, to agree upon the soundness of the principles approved at Brussels? Will not the Labour Party at any rate make a serious and impartial study of them? Will not they seriously consider whether the interests of their followers are not best served by restricting government expenditure, checking inflation, achieving stability of prices, improving the exchanges, and by, if not reducing, at least preventing any further rise in the cost of living? Must they really hold to the faith that their salvation lies here and now in the great extension of government activities and expenditure? For at any rate, until we have recovered somewhat from the war, that way no salvation lies.

To the writer they seem sometimes to ignore the fact that the community is an organic whole, of which by far the largest part consists, of course, of the manual workers themselves; that, if they increase government expenditure and necessitate additional taxation, they are taking money from themselves, since, in one form or another, the sacrifices which such taxation involves are distributed over the whole community; that, if they strike, they strike against themselves; that, if they reduce production, they reduce their own standard of living; that they cannot, as their extremists desire, render industry unprofitable without first ruining themselves; that there is no hidden reservoir of wealth except in their own energy, skill and

ability, and that of the rest of the community ; and that their salvation and the maintenance of their standard of life depends on confidence, stability and sound finance. If it were only possible for the political parties to agree on these principles, as to which no representative at the Brussels Conference, nor any of the great economists whom they consulted, had a shadow of doubt, we should have found a firm basis from which to proceed to a fruitful consideration of the great economic problems of the day—namely, the better distribution of the product of industry, the stimulus to production necessary to maintain our standard of life, and the cure, or at least the utmost diminution, of unemployment. The sound basis from which we should start would eliminate many quack remedies now current, and our financial and economic position and the well-being of our people might be quickly improved.

APPENDIX I

EUROPE'S ECONOMIC NEEDS

An Address made to the Brussels Conference by the Hon. R. H. Brand

It is my duty and my privilege to initiate the debate in this conference on the all-important question of public finance, and to speak not as the representative of any nation, but from the general international standpoint of the League of Nations. It is natural that in the time at my disposal I cannot do more than paint the very broadest picture of the subject. Nor do I claim or expect to say anything new on this vastly important and difficult problem, which is and must continue to be the constant preoccupation of all the Governments of Europe and of very many of the distinguished persons gathered here. All those present will have had an opportunity of digesting not only the economic declaration of the Supreme Council of March 8, 1920, but also the very illuminating memoranda prepared at the request of the Secretariat of the League of Nations by certain distinguished economic experts. All these documents deal largely with the problems of public finance. They will equally no doubt have studied all the other documents relating to the actual financial conditions of each country, its revenue and expenditure, its debts, funded and floating, its currency conditions, exchange and so forth. They will have, therefore, in their minds not only the general principles of public finance, which they are recommended to adopt by the great economic experts of the day, but the actual conditions in each country to which these principles must be applied. I confess that a study of all these matters leads me to the conclusion that the great difficulty before the financial leaders of the world is to know, not what they ought to do, but how they are to do it. The goal is clear ; the path to it not difficult to find ; the question is how to surmount the obstacles, in some cases the huge obstacles, both economic and political, which lie between.

Nevertheless, notwithstanding the full information which is

already before the conference, it may be useful to survey broadly the various main aspects of the present unparalleled situation. During the last 100 years, we have seen, especially in Europe, a development which is without a precedent in the history of the world. During that period and solely owing to new methods of wealth production, the capital wealth of Europe, and consequently its population, have increased at a far greater rate than ever before, until now that population is far denser than in any other part of the world. The density of population in Europe is estimated at 123 persons to the square mile; that of Asia at 53; that of North and Central America at 16 and of Australasia 2½; while the United States has 34 persons to the square mile. Belgium had before the war 665, the United Kingdom 358, Germany 324, Italy 330, and France 191. The growth and density of this European population had only been rendered possible by a highly complex organization of industry and finance, by intensive methods of wealth-production, and by a vast interchange of European manufactured articles against the food and raw materials of the rest of the world. The civilization of Europe is not self-supporting. The actual livelihood of its teeming millions is dependent on the smooth working of the great international financial and industrial machine, and on the maintenance of the fixed and circulating capital on which production is dependent. Europe, in fact, by the vast growth of her population, had given hostages to fortune, and could clearly only risk war at the cost of immense ultimate suffering and a lowered standard of life. Nevertheless, war came, and lasted four years, a period which, I think, all economists would have predicted as almost impossible. I shall not dwell on its manifold economic results. I wish merely to lay stress on one, which is the fundamental cause of all our difficulties, and which has therefore an all-important effect on public finance—namely, the huge destruction and deterioration of capital and the consequent impaired productive capacity of Europe. It is true that only in the case of certain countries, notably France and Belgium—and these cases must have our special sympathy—has the destruction of fixed capital been on a very great scale. But in all the belligerent countries at any rate, and probably in a minor degree in some of the neutrals, the loss of working capital and the deterioration of fixed capital represent a huge sum, and have had in all cases very serious and in some cases almost disastrous effects. I have seen estimates that in my own country we have lost perhaps one-sixth of our pre-war accumulated capital; in the case of other European belligerents the proportion is probably much greater. The German Government estimated,

it appears, at Spa, that the capital value of German wealth had been reduced from 220 billion gold marks to 100 billion gold marks.

It can be imagined how serious is this great loss of capital to a continent so highly developed and so densely populated. The depressing effect on industry and trade of the loss entailed by a single bad harvest is well known. Purchasing power is diminished, and production must slacken in consequence. Imagine how vastly greater must be the consequences of the war's huge destruction. The masses can only secure the goods they want in exchange for the goods they produce. Rises in prices and wages unaccompanied by increased production accomplish nothing.

The inadequacy of capital and consequently of productive power is fundamental, and therefore in my opinion it is the necessity of increasing it as rapidly as possible that should be the main guide to public finance. The wealth of a nation must precede the wealth of its Government.

First, then, this question must be put. Since there is not enough capital to go round, which is to have it, Governments or private industry? The more capital is absorbed by Governments, the less is available for private industry. It is only too clear that industry in all countries is suffering severely from want of capital. The rates of interest demanded are constantly rising, and, since not enough money can be obtained from the public, the pressure on the banks for credit becomes more and more severe. Which is likely to use capital more productively, Governments or private industry? If the answer is in favour of private industry—that is, to use the words of a statesman of my country, Mr. Gladstone, in favour of allowing money to fructify in the pockets of the people—then, except in the cases of clearest necessity, it is imperative that Governments should restrict their expenditure within the smallest dimensions.

Secondly, it is generally recognized that continued inflation, which is primarily due to excessive Government expenditure, has a serious effect on production. It is not sufficient for trade and industry merely to have capital. They must have some stability of conditions also. They require stable prices, stable exchanges, stability of the internal and external financial mechanism. The most ominous and disquieting feature of the European situation to-day is the constant fluctuation and even deterioration of the exchanges, the gulf which still exists in most countries in Europe between public expenditure and revenue, and in some of the most important countries the still continued increase of the floating debt and of currency. Inflation, as Professor Cassel has said,

"is the combined result of an artificial creation of purchasing power in order to finance Government expenditure beyond the real capacity of the country and a falsification of the money market by a too low rate of interest, in both cases with assistance of an arbitrary supply of legal tender." Inflation indeed is at bottom the result of a dearth of real capital sufficient to meet the needs of the Governments and the peoples. The greater the scarcity of capital, the more insistent becomes the impulse both on the Government and on industry to secure more purchasing power, so that all may compete for the capital they require and yet cannot get. The more impoverished becomes a nation, therefore, the worse becomes the inflation, the more prices are driven up, the worse becomes the exchanges, the more difficult it becomes to secure the imports without which production cannot continue, and the harder it becomes to remedy the disease. The only remedy for inflation is to arrest the increase of artificial purchasing power, whether it arises from the direct act of the Government in increasing floating debts or legal tender, or from an excessive creation of credit by the banks. For this remedy to be applied, there is needed in the first case an equilibrium between the Government's ordinary recurrent expenditure and revenue ; in the second case an abandonment of the practice of meeting non-productive expenditure out of loans and a limitation even of productive capital expenditure to the lowest possible amount—since no country can with advantage add still further to its public debt—and in any case its limitation to what the public can provide out of their real savings.

The first and most important duty of public finance is that a Government should pay its way. Without that there is no foundation either for its own economic life or for receiving assistance from others.

But it may be argued with force that the duty of Governments in the prevention of inflation does not stop there. Banks can inflate as well as Governments, so long as the output of currency is unlimited. It seems therefore desirable for the Governments to take such steps as are within their power to secure such a restriction of bank credit by sufficiently high rates of discount as will correspond with the real capital available for industry and trade. It is so easy to suppose that, if industry is in need of money, its difficulties will be solved by the creation of further credit ; it is so difficult to concede that cheap money may actually be harmful to production, and may raise prices. The confusion comes from failing to distinguish between credit and capital. The real limiting factor in production is not credit, but capital, the actual goods and commodities

available which cannot be increased merely by increasing credit. In 1914 the production of Europe in real goods was far greater than it is to-day; there was no lack of credit and the industrial plant was at full blast. To-day production is far lower, and yet credit and currency have been doubled and quadrupled. It cannot be a lack of credit that lies at the root of the trouble. The real evil lies in the constantly advancing prices which are always rendering insufficient the capital and resources of industry as well as the revenue of the Government, the rise in prices itself being caused by the great excess of the demands of the Government over the resources which they can obtain from the real savings of the people, by the excessive demands of industry on the available capital of the country, and, I may add, in some countries by the necessity to import food and other materials without any possibility of paying by exports, with the consequent complete demoralization of the exchanges.

There are many things we cannot now do that we could have done before the war; there are many schemes and developments we must postpone, many commodities we must do without. We must be content to produce what is of the most immediate use to the community. For this reason it is a duty of those in charge of public finance to bring about some correspondence between the supply of real capital and the supply of money by imposing or recommending sufficiently high rates of discount. That is the effective means of diverting the insufficient stream of capital into the channels where it is most needed at the moment. It is of the greatest importance that capital should, as far as possible, be applied mainly to the quick production of immediately consumable articles. High rates are the only effective method of restricting development on lengthy processes of production and of forcing commodities, if they exist, on to the market. Credit is always inclined to burst its bounds, a tendency enormously intensified in a period of rapidly rising prices. It is only by means of high rates that the pressure on the banks can be maintained within bearable limits, and can be eventually diminished sufficiently to allow once again a definitely restricted issue of currency and a stable standard of value to be re-established. If this view is correct it is interesting to examine the table in paper No. 3, *Currency Statistics*, laid before the conference, containing the Bank Rates of discount in the respective countries. The highest rates will be found in Japan, the United Kingdom, the United States, the Argentine and in the Scandinavian countries; the rates are lower in those European countries which have suffered most from the war and where inflation

is far more serious. It is naturally useless to render money scarce at one end by a high Bank Rate, while at the other end purchasing power is being rapidly increased by adding to the currency or the floating debt. A policy of high interest rates must therefore be accompanied by a cessation by Governments of the practice of creating additional purchasing power, unbalanced by any increase in production. In this connection it is important also to note that saving, which it is of such vital moment to encourage, will certainly not be stimulated by low interest rates accompanied by a constant depreciation in the standard in which such savings are measured. It is this depreciation which leads to a spirit of reckless extravagance and a determination to spend at once what in any case is likely to be lost.

There is a third way in which excessive Government expenditure impedes the recovery of the productive process—namely, by necessitating excessive taxation. I do not propose to consider the important and difficult question, for instance, as to the comparative merits of direct and indirect taxation or as to the advantages and disadvantages of a capital levy or a forced loan. These are matters which each country must decide for itself according to its special circumstances. But the principle, which I have already mentioned, that revenue should at least be sufficient to meet all ordinary recurring expenditure, including interest and sinking fund on debt, is applicable to all countries. This itself, which is a minimum demanded by sound public finance, is a task which imposes to-day on many countries very severe taxation. As soon as this taxation can no longer be paid out of real savings, it not only leads to further inflation and to further increases in prices, but it entrenches on the capital which is necessary for production. Industrial and trading companies which have to pay away huge sums in taxation find themselves short of working capital. Very likely they cannot raise the money they need from the ordinary investor, and they are driven to the banks. The banks are faced with the dilemma either of seeing the industry in question collapse or of granting them credit. As long as an unlimited supply of currency can be obtained from the issuing authority, the banks, of course, can provide themselves with resources, but at the cost to the community of further inflation, and of a further step on the downward path. Moreover, excessive taxation, while limiting the possible profits of enterprise, does nothing to lessen the risks of loss. Consequently it is bound to have for this further reason a depressing effect on production.

From whatever angle, therefore, the problem is examined, one

is driven always to the same conclusion that the greatest interest of public finance should be to limit Government expenditure. To follow this policy at all costs, and to accompany it by sufficiently high money rates, seems to be the only means of arresting inflation, reaching stability in prices and exchanges, and rendering possible the rehabilitation of foreign trade, the only means, in fact, by which, through the encouragement of production and saving, Europe can within a reasonable period replace the capital lost in the war.

It is easy to enunciate such principles. Few people will dispute them. But an examination of the actual facts of the situation quickly reveals the extreme difficulties in the way of putting them wholly into practice. The figures I have been supplied with by the Secretariat of the League of Nations show how enormously net Government expenditure has increased proportionately to the total national income in the case of nearly all countries. This percentage has increased in the case of the United Kingdom from 7·7 per cent to 26 per cent, and in the case of France from 12·8 per cent to 35·7 per cent, and these are merely typical examples. The largest items in the budgets of European Governments to-day are, of course, the direct consequence of the war, such as armaments, interest on debt, war pensions, subsidies on food, houses, and so forth, and deficits on public undertakings such as railways. In certain cases the largest item of all is the actual reconstruction of devastated areas.

The expenditure on reconstruction, the great sums spent on the service of debts and on pensions, together with the civil service expenditure on the normal functions of Government—for instance, justice, education, and so forth—cannot well be reduced, and these amount to a very large proportion of any budget.

But large economies can certainly be made, if it is determined, first, to reduce expenditure on armaments ; secondly, to abolish all such uneconomical expenditure as unemployment doles, subsidies on bread, coal, housing and so forth ; and thirdly, to raise railway rates, postal rates and other Government charges sufficiently to cover the cost of the service given. All such uneconomical expenditure, if persisted in, must result in undue consumption and further inflation through an increase in Government expenditure unbalanced by revenue. The more they are indulged in the more difficult they are to dispense with.

Any large reduction in the expenditure of Governments can only come, therefore, through a change of policy, a determination, so far from extending, to diminish the sphere of Government activity.

"Give me a sound policy," is a well-known saying, "and I will give you sound finance."

It is idle to disguise from ourselves the difficulties of the task. It is a paradox of the situation that, urgent as is this limitation of expenditure on financial and economical grounds, the whole force of public opinion still seems to be exerted in the opposite direction. The war has led to an almost universal demand for the extension of Government functions. Every one has grown accustomed to State assistance and State activity. Socialism and nationalization are the order of the day. The manual workers, at any rate in some of the victorious countries, were encouraged to expect, and do expect, some new way of life; some great betterment of their lot. These changes, they believe, at any rate in my country, can be achieved if the system of private industry is replaced by some sort of Government or common ownership. They do not realize the hard truth that no system can immediately restore capital that has been destroyed, and that, whatever changes are made, a better life can, owing to the losses of the war, be now only reached through labour and suffering. Many social reforms await fulfilment, but the first of all, on which all others depend, is sound finance and a stable currency.

One urgent task—namely, the reduction of armaments—can only be tackled by all Governments jointly. Europe, it is estimated in the figures provided by the Secretariat of the League of Nations, is spending to-day on armaments, calculated at pre-war prices, at least as much as and, indeed, still more than she was spending in 1913. It is a burden she cannot support.

Apart from the limitation of expenditure, another important function of public finance is to provide not only the interest upon, but also a definite sinking fund to redeem gradually the funded debt; and to fund as soon as possible the floating debts which at present form a danger to financial stability. Financial stability and confidence can never be restored so long as Governments are faced with the risk of having to meet enormous demands for the repayment of short-dated debt by the issue of additional paper currency. But it should be observed that only when it is provided out of an actual surplus of revenue over expenditure does the application of a sinking fund to the funded debt actually reduce debt. The funding of the floating debts, failing any possibility of reducing them out of revenue, or by methods of compulsion, is contingent on the confidence which the people of a country feel in its Government and in the power of that Government to attract its people's savings towards long-dated public loans. There are many

advocates of compulsory methods, such as a capital levy or forced loan, to secure an immediate large reduction in the debt. It is questionable whether such methods are from the practical point of view likely to show advantages over a more gradual process.

The Governments of all the great belligerent countries must also undertake the solution of the problem of their external debt, reparation being from this point of view tantamount to the external debt of Germany and Austria. The largest creditor of the allied nations is of course the United States, to which nearly \$11,000,000,000 was owing on March 1, 1920. It is interesting to note that the total European exports to the United States in 1919 were in value \$750,000,000, representing, if they were all available in payment of interest upon and redemption of debt, a return of a little under 7 per cent. For two reasons, however, this is not a fair criterion of Europe's capacity. In the first place, 1919 being the first year after the war, is not a representative year, and in the second place, Europe's capacity to repay the United States depends not only on her exports to that country, but on any favourable balance she may have in other countries as well. Nevertheless, it is obvious to every one, debtor and creditor alike, that time for the repayment of these debts must be given. What is required in the interest of public finance and of the financial community as a whole is certainty, and that these and other foreign debts should be funded and the redemption dates fixed definitely. Unless this is done every Government is left in a state of harassing uncertainty, which undermines confidence and tends to affect adversely the situation.

During the war the belligerent Governments paid little or no heed to economic laws. Their objects were to concentrate all the economic power of their own people on warlike energies and to destroy the economic power of their enemies. Many restrictions were therefore imposed on free dealing and free trade internally and many measures adopted, such as the limitation of the rent of houses, or the imposition of maximum prices, or the control of capital issues or of the exchanges, which were designed either to prevent the full force of the true economic situation from falling on the mass of the people, or to limit all national activities to war. Similarly there were many restrictions of external trade, extending in the case of the enemy to complete cessation of all relations and to confiscation of private property.

There are many relics of this system so far as internal conditions are concerned. It is certain that, from the point of view of these, rapid production of wealth, the interference by Governments

with ordinary economic laws, is almost wholly mischievous. It is no doubt true that the circumstances produced by the war and these exceptional measures are so abnormal that complete freedom—for instance, in gold movements, or in certain exceptional cases as regards the price of food or other articles—can only be restored gradually. There may also be cases where some restriction is necessary—for instance, in order to prevent the export of capital to escape taxation, or where the external value of a currency is much below its internal value. For in such a case a country may be drained of its resources by the bonus on export, as happened in what is known as Germany's "clearance sale." But in general these restrictions give rise to a constantly growing series of other difficulties. It should, therefore, be the aim of Government to give back freedom to individual initiative in all matters of finance, commerce and industry with the least possible delay.

So far as international relations between one country and another are concerned, the difficulties are greater and the evils of the present situation still greater too. There is far less freedom of trade between the countries of Europe now than before the war. Inter-state rivalry is far more acute, and there are far more states to be rivals. Among many states it seems to be considered the height of economic wisdom to reserve the resources of the state exclusively to its own citizens, or, if its products are allowed to be exported, to distribute them according to political considerations. If all these countries were as prosperous as they cared to be, then political considerations might be allowed to govern. But they are ruined, and the resources they each possess within themselves can never suffice to extricate them from their difficulties. Thus their only salvation is freely to trade with one another and so pool their resources. No recovery on other lines is possible. Europe must have real peace and real international co-operation. This is the conviction that deepens on me personally every day. I am here representing no particular country, but free to regard the problems before us as a citizen of Europe. I live my life in the profession of international banking, and day by day my business brings me in touch with many aspects of international economic relations, and proves to me that by far the greatest obstacle to the resumption of normal conditions is Europe's political instability and uncertainty, which clouds every international business transaction with a risk that no man of business is able to measure. My experience convinces me that Europe has two paths only open to her. Either she may take the path of despair and assume that the sort of peace we have now is merely an interlude between wars, or she may take the path of

hope and accept the risks of mutual trust, Government between Government and nation between nation. In the first case I see no hope either of real economic recovery or of a stable future for western civilization. If she chooses the second path, the pessimists may still be right. Our divisions may be too deep and in our mutual trust we may be deceived. But even then we shall be no worse off than if we had taken the other path, and at least we shall have given ourselves the chance of success. But I myself am an optimist. I lived many years of my life in South Africa and have seen for myself the wonderful results of mutual trust between former foes. Inevitable difficulties recur, and it is many years, indeed generations, before the past is obliterated. But if the seed is once well sown the tree will grow.

APPENDIX II

MEMORANDUM ON THE ALLIED FINANCIAL POSITION

(August 29, 1916)

1. The principal danger of the Allies losing the war now lies in a collapse of their external finance, which will cut off some supplies which are absolutely necessary to them. This danger will turn into a certainty within the next twelve months unless measures are taken immediately to forestall it.

2. It must be recognized that the Allies, whatever manufacturing capacity they may develop, cannot continue the war unless they continue to be supplied with a certain quantity of supplies from the United States—e.g., some food, some copper, nickel, some steel, etc. They will not get these supplies unless they can pay for them.

3. It does not appear to have been realized that for making payments in the United States the resources of the British Government—which has to pay for all the Allies—are strictly limited. It cannot pay, as it and all other Governments can pay for internal expenditure, by creating credit. It has a limited sum at its disposal in the shape of gold and dollar securities and no more. When that is exhausted it can buy no more, not even the most necessary supplies.

4. Both British and Russian purchases in the United States up to the present have apparently been based on the theory that Great Britain had either unlimited or very elastic resources to draw on in payment for these purchases. If it had been realized that this was not so, no doubt greater care would have been exercised so as to spread out the amount available over a longer time.

5. In the first two years of war the British Government for itself and its Allies spent between 300 and 400 million pounds sterling in purchases in the United States. It borrowed 50 million pounds in New York (its share of the Anglo-French Loan) and paid for the rest partly by exporting gold, but mainly by the sale of dollar securities which were gathered in from British holders.

6. The British Government has to pay a further 500 million pounds sterling or thereabouts in the United States for the balance of orders already given or about to be given by itself or its Allies. Most of this 500 millions will fall due before June, 1917—except in so far as orders can be cancelled.

7. The payment of this 500 million pounds will nearly or quite exhaust the balance of our dollar securities and the gold which we and our Allies can give up. We shall then have no further means of making payments in the United States, and shall be unable to obtain even the most necessary supplies, such as copper, without which we cannot continue our own manufacture of munitions on an adequate scale.

8. An additional consequence of the exhaustion of the Government fund for making payments in the United States will be the collapse of the dollar exchange. At present, apart altogether from Government purchases, the civil population of Great Britain import from the United States far more than they export. Consequently, even after allowing for the credits due to Great Britain on account of freight, etc., exchange is now only kept up by the Treasury making large weekly payments to New York for that purpose. These payments come out of the fund created from the sale of dollar securities, which is thus still further diminished.

9. As soon as the Treasury is no longer able to make these payments there will be a complete collapse in American exchange, one effect of which will be an enormous rise in the prices of foodstuffs in the United Kingdom and France. They may be expected even to treble or quadruple all at once, meat going to ten shillings a pound, and bread to half-a-crown a loaf.

10. The above position has arisen through orders being given in the United States as if our resources for payment there were unlimited. If the truth had been understood and orders had been limited to what was absolutely necessary, probably they would have been cut down by half, thus spreading the amount available over twice the time. The spending departments cannot be blamed for their attitude in the matter. Their business is to provide whatever may be likely to be required in the fullest possible measure with a margin over in case of accident. Often to place large orders in the United States seems the best way of making the provision. That is still their attitude. Consequently orders continue to be placed in the United States both on British and Russian account, not because they are really essential, but because they give a useful margin of supply, or as an insurance against failure to produce elsewhere, or simply because it seems the easiest and

quickest way of getting the supplies, as compared with the trouble and possible delay of arranging for the production of them at home.

11. This would be a perfectly proper attitude on the part of the spending departments, if we had unlimited means of paying in the United States. In the actual circumstances of the case it is a suicidal policy, since it is leading inevitably to a speedy collapse of our credit there, which will deprive us and our Allies of supplies which really are necessary to the continuance of the War.

12. If expenditures in the United States are continued on their present scale such a collapse must inevitably come some time between June and December, 1917. (That is not to say that it might not come earlier by accident or mistake.) If therefore the Government wish to be in a position to continue the war after that date, they will have to take the following measures at once :—

(*a*) To go through the outstanding orders and cut them down as far as possible. It is notorious that there are orders for hundreds of millions of dollars outstanding in the United States for articles which are no longer required, but which will be delivered and have to be paid for in 1917 unless the orders can be cancelled.

(*b*) To establish a financial control over the spending departments as far as expenditures in the United States (or other neutral countries) are concerned. No further order whatever should be placed in the United States (or other neutral countries) till it has been passed by this financial control, which should see that it is cut down to what is strictly necessary, having regard to the total sum available for payments in the United States and to the purchases which have to be covered as long as the war continues.

13. The old financial control of the Treasury over the spending departments is in abeyance, and would hardly be suitable for the purpose indicated in the above paragraph, even it if were possible to re-establish it. Probably what is needed is a special committee of control on which both the Treasury and the spending departments would be represented and which would itself be responsible to the War Council or to a Finance Committee thereof.

14. The enemy are undoubtedly aware of the position. The extent alike of our resources and of our commitments in the United States must be known to them, at any rate approximately. If they know we are running into a collapse within a year or eighteen months at the outside, they have every inducement to hold out if possible till this takes place. This inducement is removed if they know we are prepared and able to go on longer if necessary.

15. It is supposed by many people that even when our gold and dollar securities are exhausted we can borrow indefinitely in the United States either on our unsupported credit, or by using other foreign securities as collateral, or even British (e.g., railway securities). This is not the case. The American investor will buy back his own dollar securities as long as he has the money to do so, but he will not buy foreign securities of any kind in any quantity. The Anglo-French Loan is not yet absorbed by the private investor. Consequently any lending on British credit or on foreign securities can only be done by banks and trust companies and the quantity of loans which these can absorb on any terms whatever is limited. Probably it does not exceed at the outside one hundred and fifty millions sterling, which at our present rate of expenditure in the United States would not last us for four months. In this connection it must be remembered that nearly all the foreign securities held here, except the American, are in sterling and that if exchange is threatened the value of sterling securities as collateral would be at once gravely impaired. This would be likely to prevent even the American banks from accepting sterling securities as collateral beyond a limited amount. But even if the banks regarded such securities as acceptable collateral without reserve, they cannot go on indefinitely increasing loans which they cannot pass on to the investing public.

Printed in Great Britain by Butler & Tanner, *Frome and London.*

Telegrams: "Scholarly, London."
Telephone: 1883 Mayfair.

41 and 43 Maddox Street,
Bond Street, London, W. 1.
September, 1921.

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It may be of interest to add that Mr. Farrer, fascinated by his experiences among Chinese people and Chinese flora, started last year on another adventurous journey into Southern China, but unhappily succumbed to illness in Upper Burmah in December, 1920.

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